

104
NOMINATION OF GINGER EHN LEW TO BE
DEPUTY ADMINISTRATOR OF THE UNITED STATES
SMALL BUSINESS ADMINISTRATION
AND
THE UNITED STATES SMALL BUSINESS
ADMINISTRATION'S FISCAL YEAR 1997 BUDGET

Y 4. SM 1/2: S. HRG. 104-538

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HEARING
BEFORE THE
COMMITTEE ON SMALL BUSINESS
UNITED STATES SENATE
ONE HUNDRED FOURTH CONGRESS
SECOND SESSION

MAY 1, 1996



Printed for the Committee on Small Business

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C O N T E N T S

OPENING STATEMENTS

	Page
Bond, The Honorable Christopher S., Chairman, Committee on Small Business, and a United States Senator from Missouri	3
Kempthorne, The Honorable Dirk, a United States Senator from Idaho	8
Wellstone, The Honorable Paul D., a United States Senator from Minnesota ..	8
Bumpers, The Honorable Dale, Ranking Member, Committee on Small Business, and a United States Senator from Arkansas	42
Snowe, The Honorable Olympia J., a United States Senator from Maine	56

WITNESS TESTIMONY

Pelosi, The Honorable Nancy, a Representative in Congress from California ...	1
Lader, The Honorable Philip, administrator, U.S. Small Business Administration, Washington, D.C.; accompanied by Bernard Kulik, associate administrator for disaster assistance; Patricia R. Forbes, acting associate deputy administrator for economic development; and Greg Walter, acting chief financial officer	13
Lew, Ginger Ehn, nominee to be deputy administrator, U.S. Small Business Administration, Washington, D.C.	44

ALPHABETICAL LISTING

Bond, The Honorable Christopher S.	
Opening statement	3
Prepared statements	5
Bumpers, The Honorable Dale	
Prepared statement	42
Kempthorne, The Honorable Dirk	
Opening statement	8
Lader, The Honorable Philip	
Testimony	13
Prepared statement and attachments	17
Lew, Ginger Ehn	
Testimony	44
Attachments to statement	47
Pelosi, The Honorable Nancy	
Testimony	1
Snowe, The Honorable Olympia J.	
Prepared statement	56
Wellstone, The Honorable Paul D.	
Opening statement	8
Prepared statement	11

COMMENTS FOR THE RECORD

Boxer, The Honorable Barbara, a United States Senator from California, letter	70
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**NOMINATION OF GINGER EHN LEW TO BE
DEPUTY ADMINISTRATOR OF THE UNITED
STATES SMALL BUSINESS ADMINISTRATION
AND
THE UNITED STATES SMALL BUSINESS AD-
MINISTRATION'S FISCAL YEAR 1997 BUDGET**

WEDNESDAY, MAY 1, 1996

UNITED STATES SENATE,
COMMITTEE ON SMALL BUSINESS,
Washington, D.C.

The Committee met, pursuant to notice, at 9:42 a.m., in room SR-428A, Russell Senate Office Building, the Honorable Christopher S. Bond (Chairman of the Committee) presiding.

Present: Senators Bond, Kempthorne, Bennett, Snowe, Bumpers, and Wellstone.

Chairman BOND. Good morning and welcome to this hearing of the Small Business Committee. Please accept my sincere apologies for the delay in starting. I was doing an extensive interview on Small Business Week, and I figure that is at least a plausible argument for being late. I have talked with our ranking member, Senator Bumpers, who has, I think, two markups scheduled this morning. Normally, I do not like to go ahead without him because he is a very faithful attendee, but with his heavy workload today I thought that we would go ahead.

Before making my opening comments about the nomination of Ginger Lew to be deputy administrator of the Small Business Administration, I note that Congresswoman Pelosi is with us and I know that your schedule is busy. You may have some comments that you would wish to offer us before we get into the business of the hearing.

**STATEMENT OF THE HONORABLE NANCY PELOSI, A
REPRESENTATIVE IN CONGRESS FROM CALIFORNIA**

Ms. PELOSI. Thank you very much, Senator. I appreciate the opportunity to be here this morning. It is really a personal pleasure, but also a professional one, to be able to introduce to the Committee Ginger Lew.

Ginger Lew, as you know, is being considered for the position of deputy administrator for the Small Business Administration. While I must confess, Senator, that I was not aware that this is Small Business Week, I think it is very appropriate that we consider the nomination of Ginger Lew at this particular time because I think

it will be in furtherance of small business advocacy in our country which is, as you know, so very important to our economy.

I believe, Senator Bond, that Ms. Lew will bring to the SBA broad experience in Government and in the private sector that will be very useful. As you may be aware, Senator Bond, Senator Kempthorne, and members of the Committee. Ginger Lew has over 20 years of experience in the private sector and in Government, including a key role in a startup, high technology small business venture, a biotech company. As you know, we are both from California and one-third of the biotech companies are in California. Ms. Lew served most recently as a top advisor to Secretary Brown at the Department of Commerce.

I know I speak for all the members of our California delegation when we say how proud we are of your consideration of Ginger Lew. At the Department of Commerce, Ginger Lew was general counsel and supervised a staff of 375 attorneys and legal professionals. She played an important role in international trade negotiations, economic development in telecommunications policy, export control issues, intellectual property disputes, and alternative methods of dispute resolution.

A native Californian, indeed a native San Franciscan, Ms. Lew received her law degree in 1974 from the University of California and a bachelor's degree in political science from UCLA. She has been active in civic and Asian-American organizations in San Francisco such as the Wu Yee Children's Center, the Asian Law Caucus, and Chinatown Self-Help for the Elderly. Indeed, I might like to note, and probably I should leave the privilege to Ginger Lew, but it gives me such pleasure to note that Ginger's family is here with her this morning and she will introduce them I am sure. But again, as a San Franciscan I am very proud that they are here to enjoy this very special moment for Ginger.

Ms. Lew was also a co-founder of the Asian-Pacific American Bar Association. Previously, Ms. Lew worked with Energo, a biomass technology firm based in San Francisco, as I mentioned earlier. As vice president and general counsel, she was involved in all phases of the company's operation including product development and licensing, patents, regulatory affairs, international marketing, and financing.

She also spent 5 years with Arthur Young & Company advising small businesses as well as Fortune 500 companies with a primary focus on international markets. Her clients included manufacturers of computer hardware and software, environmental technology, and consumer goods, and professional services. A former Deputy Assistant Secretary of State for East Asia during the Carter administration, she is also the co-author of two books on international trade issues.

As deputy administrator, Ginger Lew hopes to assist throughout the country to do what she accomplished earlier in her career, lead the way to growth, job creation, and financial success for small businesses in our country. Mr. Chairman, and members of the Committee, as you see by dint of her extensive experience in the small business arena she is superbly well-qualified for the position of deputy administrator. For that reason, once again I say it is a privilege to speak for the members of the California delegation, and

personal pride for me to add my support to the administrator who is with us this morning as well.

I thank you for your consideration and for giving me the opportunity to introduce Ginger. Now this is supposed to be the introduction, but your gracious hospitality has enabled me to introduce Ginger a little early because I know that you will now go into the other part of the program. But I did want to put her qualifications on the table and let you know the great deal of support that she has in California for this position.

Chairman BOND. Thank you very much, Ms. Pelosi. You are welcome to stay as long as you wish, but as I said, I know that you have many other duties on the House side. We do appreciate your very informative words about Ms. Lew. They will be of great interest and they will be in the record for our colleagues who are not able to join us this morning.

Again, it is always a pleasure to hear from a colleague who has personal knowledge of the credentials and the background and the qualifications of nominees. So thank you very much. It is most helpful to us in our deliberations.

Ms. PELOSI. Thank you, Mr. Chairman. I have a markup in Intelligence so if you will excuse me. Thank you very much.

Chairman BOND. Thank you very much for being here.

OPENING STATEMENT OF THE HONORABLE CHRISTOPHER S. BOND, CHAIRMAN, COMMITTEE ON SMALL BUSINESS, AND A UNITED STATES SENATOR FROM MISSOURI

As I think most of you know, this is a combined hearing both on the nomination of Ms. Lew and on the fiscal year 1997 budget. We are joined by Mr. Lader, the administrator of SBA and other members of his staff.

I should say by way of clarification, I know that the SBA has scheduled Small Business Week to be the first week in June, but Kansas City being a city of great tradition stayed with the earlier designation. So it is, I guess, Small Business Week in Kansas City, but in this Committee room it is always Small Business Week. We appreciate the opportunity every week to talk about small business.

We have already heard about the extensive experience that Ms. Lew has had both in the private sector, in corporate-legal affairs and in Government, and her work with a startup biomass technology small business in San Francisco, as well as her extensive consulting experience.

I would just note for the record that her expertise in the export area is something that I feel is of great importance to all small businesses. When we get caught up with all of the other things that we have to deal with we want to look more extensively on how we can assist more small businesses to enter the export market. That is a side track to what we are talking about here today, but I happen to believe that the opportunities for growth for all of America's economy, but particularly small business, lie in the export market. We see our large businesses actively engaged in the export market. We do not see enough small businesses, and Mr. Administrator, we look forward to working with you and Ms. Lew on that one.

Let me just make a comment or two about the 1997 budget year. As you recall, back in 1996 we set forth a plan for a balanced budget. We needed to get discretionary spending under control. As a result, we worked in this Committee on a bipartisan basis with the SBA to keep the expenditures down. We know that small business cannot continue to succeed if it runs a negative cash-flow.

The Federal Government is different, but we think that the Federal Government getting its budget in balance has some tremendous benefits for small business particularly, as well as, for the entire economy. That is why we worked to tighten up the subsidy rate on small business loans by making various improvements and refinements in the fees and other things on which we worked with the SBA. We also note the SBA is committed to reorganization and refining its structure, examining how it can best meet the needs of small business tomorrow.

I had a discussion and colloquy on the Senate floor with Senator Hatfield. We noted the need for SBA to continue to reduce its staffing level as part of the overall effort to balance the budget. I note with a little concern that SBA has submitted a budget that actually increases staffing levels. I think we need to continue our work to make sure that small business is served by an SBA that is attuned to the needs of the 21st century.

The big problem that we are going to face and small business is going to face in this budget is the revision in the credit subsidy rate which was dropped on us by the Office of Management and Budget. I tell you that we still do not understand and have not been satisfied with the information that we have received from OMB as to why that subsidy rate has gone up as much as it has, because it means with limited resources, the amount of loans that the Small Business Administration will be able to make will be substantially curtailed.

[The prepared statements of Senator Bond follow:]

PREPARED STATEMENT OF SENATOR CHRISTOPHER S. BOND, CHAIRMAN
COMMITTEE ON SMALL BUSINESS
ON THE NOMINATION OF GINGER EHN LEW TO BE DEPUTY ADMINISTRATOR
OF THE UNITED STATES SMALL BUSINESS ADMINISTRATION
MAY 1, 1996

Welcome to this morning's hearing on the nomination of Ginger Ehn Lew to be the Deputy Administrator of the Small Business Administration. Joining Ms. Lew this morning is Congresswoman Pelosi and Administrator Phil Lader.

At the time of her nomination, Ms. Lew was the General Counsel of the Department of Commerce, where she had served since her confirmation in 1993. Prior to joining the Commerce Department, Ms. Lew had 22 years of legal, corporate and government experience. Just prior to her position at the Commerce Department, Ms. Lew worked with a start-up bio-mass technology small business in San Francisco.

Before we hear from Ms. Lew, I want to give our ranking democrat, Senator Bumpers an opportunity to speak.

And then, we will hear from Ms. Pelosi, who has made the trip over from the House side. I know your schedule is busy, and we appreciate your joining us this morning.

PREPARED STATEMENT OF SENATOR CHRISTOPHER S. BOND, CHAIRMAN
COMMITTEE ON SMALL BUSINESS
ON THE UNITED STATES SMALL BUSINESS ADMINISTRATION'S
FISCAL YEAR 1997 BUDGET
MAY 1, 1996

Will the Committee on Small Business come to order. Today's hearing will focus on the Fiscal Year 1997 budget request for the Small Business Administration. Philip Lader, the Administrator of SBA will be testifying on behalf of SBA. I see he is accompanied by his senior managers.

Fiscal 1997 will be a critical year not only for the Small Business Administration, but also for the federal government as a whole. During our deliberations on the FY 1996 budget, we attempted to set forth a plan to balance the federal budget within seven years. Although this effort was generally opposed by the Administration and democratic leadership, we did achieve an actual reduction in federal discretionary spending. This was an important start in prudent fiscal management, but it is by no means the end of the war.

Small business owners are not successful when they run their businesses with a negative cash flow. And as you might expect, they are almost universally supportive of our goal to balance the federal budget for real, without the smoke and mirrors-type explanations that became commonplace in past years.

I am firmly committed to a balanced budget, and last year, I sent a letter with Senator Bumpers to the Senate Budget Committee outlining our support for SBA to reevaluate the programs its administers to determine if they are truly needed federal responsibilities. We commented that last year presented us with an opportunity to undertake a thorough top-to-bottom review to "rethink" SBA.

Reaching this goal has not been easy. After submitting its budget request last year, SBA announced its intention to undertake a significant reorganization of SBA. The Committee on Small Business did not receive any detailed planning documents or cost

analysis from SBA to implement its reorganization. Much work remains to be done in this area.

I continue to support strongly the fundamental mission of SBA. And I continue to believe SBA can be streamlined and made more efficient in achieving its mission. SBA's current organizational structure is antiquated and fails to make the best use of its resources in delivering its programs. Much work also remains to be done in this area.

Last year when Congress approved the Conference Report on the budget for SBA, I believed the reductions proposed in part by the Administration and in part by the Congress would trigger real efforts to streamline SBA. In fact, during the Senate floor debate on SBA's budget, Senator Hatfield and I entered into a colloquy regarding the need for SBA to continue to reduce its staffing level as part of the overall effort to balance the budget. Now, SBA has submitted a budget request that actually increases staffing levels!

I remain firm in my belief that SBA must look to the future and decide how it will meet the needs of America's small business entrepreneurs. The federal government is not growing -- we all know it is shrinking. Today's successful leaders are creating a vision of the organizations of tomorrow. Successful companies and organizations are maximizing the use of technology and training to meet the demands of tomorrow's workplace. The challenge for you at SBA today is to define the SBA of the year 2000 or 2005. As Chairman of the Committee on Small Business, I will be as supportive as possible when it comes to making SBA an element of the 21st Century. Where you will lose my support is by tinkering around the edges of the Agency trying to preserve the past while ignoring the future. We owe it to America's small businesses to do our best on their behalf to prepare for tomorrow's Small Business Administration.

Now I will turn to my good friend and ranking democrat, Senator Bumpers.

On the basis of first arrival I will turn now to Senator Kempthorne for his opening comments. Thank you for joining us today.

OPENING STATEMENT OF THE HONORABLE DIRK KEMPTHORNE, A UNITED STATES SENATOR FROM IDAHO

Senator KEMPTHORNE. Mr. Chairman, thank you very much. Mr. Lader, and Ms. Lew, good morning to both of you. Mr. Chairman, I would like to first acknowledge—and I know that in your State of Missouri you experienced the dilemma, the crisis that comes with flooding. We have had that same experience in the State of Idaho in February. In fact, it is hitting us again this month.

But I want to acknowledge Mr. Lader's efforts on behalf of ensuring that the Small Business Administration was there to help people that qualified. I spoke to him on a Sunday afternoon and he quickly activated all the resources. And also Berkie Kulik, who is with the Small Business Administration. My staff just sing the praises of Berkie. So again, I commend and I thank the Small Business Administration for your efforts. That is how Government is supposed to work in time of crisis, and it worked very well.

With regard to the nomination of Ms. Lew as the deputy administrator, I had a very, very pleasant meeting with Ms. Lew. It is very apparent that she has the entrepreneurial spirit; a great background for this position. I think she is a very strong nomination to this particular position, so I look forward to enthusiastically supporting that nomination.

In our conversation, Ms. Lew, I appreciated what I sensed was a strong attitude and a commitment that you will not be captured by Washington, D.C. in this position, but that you will ensure that you also have the opportunity to go out and to sit down with the small businessmen and women and to get from them their first-hand perspective so that we can continue to cut whatever red tape may need to be cut, and to just realize that we are trying to make this work for those small businessmen and women. So again, I appreciate that and look forward to supporting this nomination.

Mr. Chairman, thank you.

Chairman BOND. Thank you very much, Senator Kempthorne.

Now we turn to Senator Wellstone. Thank you for joining us once again, Senator Wellstone.

OPENING STATEMENT OF THE HONORABLE PAUL D. WELLSTONE, A UNITED STATES SENATOR FROM MINNESOTA

Senator WELLSTONE. Thank you, Mr. Chairman. First of all, hello to Mr. Lader. Good to see you. Ms. Lew, I will echo the comments of my colleague from Idaho. We had a very good meeting, Mr. Chairman, and I think Ms. Lew is eminently qualified not only in terms of her professional ability and background but also in terms of her commitment to the small business sector of the economy.

Mr. Chairman, I do not know whether Ms. Lew's family is here or whether they have been introduced. Could we do that?

Chairman BOND. We are going to call on her to make a statement.

Senator WELLSTONE. That will be later?

Chairman BOND. Yes, we have it carefully orchestrated.

Senator WELLSTONE. Then I will just say hello to—

[Laughter.]

Senator WELLSTONE [continuing]. Sorry to—when you have got a slick Chairman like this, what can you do? Hello to the family.

I wanted to very briefly make some comments about the budget request. First of all, I think, Mr. Lader, that you should be commended for your forthrightness in undertaking a rigorous study and bringing what is not necessarily welcome news to the Committee. But I think that your candor and your professionalism is much appreciated. I want to talk a little bit about your request for the additional \$180 million for the 7(a) program.

Mr. Chairman, regarding the 7(a) program, we can look at Minnesota as a case study—and then I will try and explain what my concerns are here. Minnesota last year led the Nation in loan volume. We had 1,770 loans worth \$223 million. That is what we leveraged. That is 7(a), 504 program, and other SBA credit programs combined. 7(a) alone nationwide leveraged about \$11 billion. You can tell me if I am wrong. That is \$11 billion of loans to small businesses that otherwise would not be made.

Every time I meet with the small business community, whether it be the Chamber of Commerce's working committee on small businesses, whether it is the White House Conference people, everybody talks about this issue of access to capital and its importance.

Now last year we went through this, and I think the Committee in a bipartisan way—and I have sung your praise over and over again, Mr. Chairman—I think we came up with a rescue plan, a bipartisan agreement that was very, very important. I was proud to be a part of it. But I have to say, with a considerable amount of certainty that I do not think the lenders nor the borrowers in my State will be able to tolerate yet additional fees to this program.

So what I want to suggest today is one or two things. No. 1, I am not arguing that there cannot be yet further streamlining or efficiency. We always look for that. Though again, in Minnesota we have one office. I will tell you that the director, Ed Daum, is unbelievable. I do not find anywhere in the State criticism from lenders or borrowers about the SBA office in Minnesota. It has just been very successful, especially when people have plenty to say in the negative, sometimes with very good cause, about other Government bureaucracies.

So I just want to say to my colleagues that I think the \$800 million request is more than reasonable when I think about what this investment brings us. I think it would be extremely shortsighted to not provide the resources we need, especially when we know that so many of the jobs that are going to be created in this country are going to be in the small business sector. That so much of the mood piece in the country is, let us not have people halfway across the world making decisions over martinis. Let us have the people that live in our communities making decisions.

So if I look at one Stealth bomber—not to pick on that—but to the tune of \$1.5 or \$2 billion. One, versus a total request of \$800 million. I just want to make sure that we do not get ourselves in the position of starting to kind of go after staff and offices to the

point where we are not going to be able to deliver for the small business community.

So I support this request. I think if you look at it in the context of the overall budget, and the question of priorities, and where we spend the money, we get a tremendous amount of bang for this buck. Mr. Lader, I hope you will hold very strong to the position you have taken and that we can work together and see what we can come up with. Enough said, but I wanted to—on the basis of a lot of rich experience in Minnesota I wanted to lay this out.

[The prepared statement of Senator Wellstone follows:]

PREPARED STATEMENT OF SENATOR PAUL WELLSTONE
COMMITTEE ON SMALL BUSINESS
MAY 1, 1996

Mr. Chairman, thank you for scheduling this meeting today for two important purposes. First, I am very pleased that we are considering the nomination of Ms. Ginger Lew to become Deputy Administrator of the Small Business Administration. I had the pleasure of meeting Ms. Lew last week. I have every confidence that Ms. Lew will be an excellent Deputy Administrator, and I look forward to working with her. I hope we can vote soon in this Committee and in the full Senate on her confirmation. Ms. Lew, it is good to see you again.

Second, we will be looking at the President's budget request for the Small Business Administration for Fiscal Year 1997 - a matter of importance to my state of Minnesota. I welcome Administrator Lader back to the Committee. I want to commend you at the outset, Mr. Lader, for your forthrightness in bringing what is not the most welcome news to us here on the Committee - news of the discovery of substantially higher subsidy rates for SBA's two principal loan-guaranty programs, 7(a) and 504, if we make no changes to those programs. I am sure that you and your staff wish the numbers from your portfolio study had come out differently. It is not easy to ask the President and the Congress for \$180 million extra for the 7(a) program in these times - especially just one year after we imposed significant new fees on 7(a) lenders and borrowers.

But this is one of the most cost-effective programs in the federal government. It can withstand a rigorous, conservative analysis. Undertaking such a study was a responsible move on your part - not to mention that a re-estimate is required annually in any case. If that study's result, now that the data has been run through OMB's subsidy-rate formula, is a correction in the cost of the program, then it is our responsibility here in Congress to face the facts and make the proper budget and policy decisions.

I am willing to support the requested increase for 7(a). It is the most popular and successful small business program we have. The Minneapolis district office of the SBA, which serves all of Minnesota, led the nation last year in loan volume - 1,770 loans worth \$223 million (including 7(a), 504 and other SBA credit programs). Nationwide we are talking about \$11 billion in 7(a) lending activity. That is \$11 billion of loans to small businesses that would not otherwise be made.

Mr. Chairman, unless we have compelling evidence that the corrected subsidy rate is in error, I believe that the requested amount for 7(a) is more than worth it. I was extremely pleased to work with you last year on a bipartisan compromise bill to bring the subsidy rate for 7(a) down. I believe this Committee rescued the program. But I can tell you with some certainty that lenders and borrowers in my state will not tolerate additional new fees in this program. They say we would price it right out of existence. I would be very surprised if the feeling is different in other states.

SBA has been delivering more economic bang for less taxpayer buck. And I am willing to believe that even more streamlining is possible, including the closing of some offices. But Minnesota has only one office. Its staff works very hard and very efficiently, according to everyone in the state who works with them. Cutting SBA loan-personnel certainly won't improve the portfolio's performance. It could, in fact, substantially increase risk. I hope we can all work together, including Mr. Lader and Ms. Lew, to make sure SBA runs as cost-effectively as possible. But we also need to keep in mind that the Administration's entire request for SBA - \$800 million - is less than the cost of one unit of certain military aircraft that we seem to find worthwhile and for which money has been found in the budget during this Congress. SBA programs deliver great benefit to a lot of people and communities across the country.

I am a strong supporter of the 504 program, as well. And I am disturbed to see the jump in the subsidy rate in that program if we do not make the Administration-suggested changes. I hope this Committee can examine 504 program policy options in the near future, including the Administration proposal. I do not know at this point whether I can support that proposal.

Finally, I am pleased to see that the Administration continues to support the Microloan program. It has been a great success so far in Minnesota. I agree with the proposal to provide a small increase for the technical assistance grants in the program, to accommodate the program's growth. All our experience indicates that with these very small loans, the technical assistance component of the program is crucial to the successful performance of the small firms.

Thank you, I look forward to the testimony.

Chairman BOND. Thank you very much, Senator Wellstone.

Now as I said, since this is a joint hearing on two items let me turn now to Mr. Lader to make comments he wishes about the budget. And I am sure he may wish to add a few words about Ms. Lew before we turn to her for her statement and then begin the questioning.

Mr. Lader.

Mr. LADER. Let me be sure I understand. You would like me to address the budget as well at this point?

Chairman BOND. Yes.

Mr. LADER. Very good.

STATEMENT OF THE HONORABLE PHILIP LADER, ADMINISTRATOR, U.S. SMALL BUSINESS ADMINISTRATION, WASHINGTON, D.C.; ACCOMPANIED BY BERNARD KULIK, ASSOCIATE ADMINISTRATOR FOR DISASTER ASSISTANCE; PATRICIA R. FORBES, ACTING ASSOCIATE DEPUTY ADMINISTRATOR FOR ECONOMIC DEVELOPMENT; AND GREG WALTER, ACTING CHIEF FINANCIAL OFFICER

Mr. LADER. Thank you for the opportunity for us to be with you. I simply want to say by further introduction of Ginger Lew that to me she really demonstrates by her life and her career that America works. I say that in two senses. If you look at her family's background, her parents, as mine, came to this country seeking more opportunity, more freedom for their children, for their lives, and they have found it, and we have found it.

Second, I started working with her in the very early days of this Administration and found her to be an individual who dots the I's, crosses the T's, brings a wealth of professional experience from the private sector to the questions of Government as well. So in the work of international relations, what we are doing to go global for small business as well as being the chief operating officer of the agency, we hope that the Senate will be able to move swiftly to allow her to come and help us.

You should know that virtually every one of my friends and acquaintances at the Commerce Department has stopped me to say, how in the world have you gotten Ginger to come join you. It is a great loss for the Commerce Department. But if the Senate so acts, it is a great gain for the SBA and we are delighted that she is under consideration with this Committee.

If I might move forward to some comments about the budget, sir.

Chairman BOND. Please do.

Mr. LADER. As you are well aware, through the public-private partnership that we have operating today, the SBA has an extensive presence throughout the country far beyond the number of specific SBA offices. If you would look to the second sheet of the slides that have been presented to you, you and the other members of the Committee would see, much as Senator Wellstone has pointed out for Minnesota, the direct economic impact in this past year of the various SBA financing programs in each of the States. I look to Idaho, almost \$100 million, for example, \$233 million in Missouri.

The principal one of these programs, the cornerstone, as you are well aware, is the 7(a) program which, Mr. Chairman, you have ad-

dressed as well. If you look at the phenomenal growth of this program you see in 1991 that 19,000 loans were made. We last year did almost 60,000 loans, a threefold increase in that period of time. The aggregate dollar amount has also continued to grow. The only reason it dipped last year is because of the appropriated funds for our subsidy rate which allowed us only to go to this level.

This is where we are this year, and the President's request would allow us to go to \$11 billion to meet the demands of growing small businesses. We will come back to that.

There are various criteria by which loan portfolios are considered. We have a \$32 billion aggregate portfolio at the SBA today. But one of the conventional criteria used by commercial institutions is the currency rate: the percentage of the loan portfolio whose payments are being made promptly on a regular basis. Here you see in fiscal year 1986, the currency rate of the 7(a) portfolio was under 75 percent. Today, it is over 90 percent, which is a very healthy sign. One of several positive indicators about the 7(a) portfolio.

If you look at the 504 program, which we believe is very important for successful small businesses growing with fixed asset acquisitions, this again is truly a public-private partnership. Here you see the growth of the program from fiscal year 1991 through the President's request this year, \$6.5 billion that would be financed.

Chairman BOND. Phil, I do not know if others are having the same trouble, but if you would tell us roughly what the maroon and black shaded areas indicate. I cannot read it from here.

Mr. LADER. Absolutely. Thank you for asking that. The maroon represents the percentage of the financing that is actually the guaranteed amount by the Government. The blue is the private sector contribution. So I am glad you asked that question. It is a great demonstration of how this too is a public-private partnership.

In response to your comments about—

Chairman BOND. Since you are giving the budget presentation we will not ask that you stay within the 5 minutes. We will extend your time, so I will have them turn off the lights.

Mr. LADER. Thank you. I will still be brief though. I appreciate that.

In terms of the number of SBA employees, the National Performance Review under the Vice President's leadership in the downsizing of the executive branch proposed that this be the downsizing undertaken by the SBA. We in this Administration, my predecessor and I have taken a far more aggressive approach to downsizing the agency. So in fact, since the start of this Administration we have had a 21 percent decrease in the total number of SBA employees.

If you look here, you see at the start of this Administration we had 3,850 and today we have about 3,030 employees. In fact, in our headquarters we have had in this Administration a 28 percent decrease in the number of employees, and in the 18 months of my watch we have gone down 18 percent in our headquarters alone.

Let me point out, if I might, the disaster loan program that Senator Kempthorne referred to is the SBA that nobody knows. Very few who are not directly involved with a natural disaster are aware

of SBA's involvement. We have been of service to every one of the States in considerable magnitude.

But what has been not understood about that program because of the name of our agency is that if you look at the fiscal year 1995 disaster loan activity, more than three-fourths of the loans were for residences or for homes. Less than a quarter of them were for businesses. And not just small businesses. These are big and small businesses. If you look at the aggregate dollar amount, more than half of the disaster loans provided by the SBA were for residential purposes. So it needs a point of clarification.

As we will get into greater detail, the principal, if not the nearly exclusive reason for the increase in the President's budget request came about as a result of the rise in the subsidy rate from OMB. That, of course, is a result of the credit reform analysis undertaken by our agency in response to the Credit Reform Act.

I must tell you, this is the most comprehensive review of a loan portfolio undertaken by any major credit agency. That is the opinion of OMB, not just of SBA. We analyzed a portfolio of loans from 1983 through 1995; 600,000 loans, 25 million transactions. As we went through that analysis what OMB found from the data was that the loans in the mid-1980s did not perform as had been projected. So while there can be different theological approaches to how you determine subsidy rates, it is OMB's prerogative by statute to determine what the subsidy rate is. I will come to that in a moment.

But in response to the conclusions OMB drew, there are a variety of legislative and administrative changes that we can do, and just this last year we found common ground between the executive branch and the Congress. I hope that this year we will be able to find similar solutions to deal with a subsidy rate challenge.

Now the subsidy rates work for you and against you. My final point is this, if you look at the SBIC programs; the largest venture capital provider to truly small businesses in the country, because of the reforms proposed with the President's budget, recommended principally by the industry, OMB was able to show a significant reduction in the subsidy rate in the SBIC debenture program, and similarly, a significant reduction in the subsidy rate in the SBIC participating security program.

The MicroLoan program, for which Senator Bumpers has particular enthusiasm, has been flourishing. I am pleased to say that in the President's budget, here again OMB concluded that the subsidy rate could be significantly reduced.

In the disaster program, because of the recommendation in the President's budget that we move from the current approximately 4 percent rate for financing of loans paid by disaster loan recipients to the cost of money to the Treasury, we would be able to have a very significant reduction in the disaster subsidy rate. So that is the good news of subsidy rate changes.

The challenge we have is in the 7(a) program. As you think back, as you and Senator Bumpers can particularly well remember 3 and 4 years ago, the subsidy rate was up here. Because of changes in the program with the Congress and through our executive branch efforts we were able to get the subsidy rate down to 1.06. But the subsidy rate change from OMB would lift it back to approximately

the same level as the prior year, 2.68. This is what consumes the principal portion of the additional amount in the President's budget request.

Frankly, if the 504 program underwent the same analysis and the same challenge of subsidy rate, it would require an additional \$180 million beyond the President's request to have the same level program next year as this year.

Senator BUMPERS. Say that again, Phil. I do not understand that.

Mr. LADER. Because of the change in the subsidy rate in 504, if we did not change the way the program is administered it would require an additional \$180 million to keep a constant level in the 504 program. Committed to a balanced budget and to deficit reduction, the President and certainly all of us at SBA wanted to avoid having that additional \$180 million request, though we recognized the critical importance of the 504 program to small businesses.

So what the President has recommended is that we move back to direct funding of the program, much as the predecessor 503 program had for more than a decade. This is not direct loans, but it is direct funding. Consequently, the way it is scored by OMB, it would not require the \$180 million appropriation. Consequently, that allows the President's budget to go to \$800 million.

Certainly, I regret as much as anyone, on my watch asking for additional funds. But as you know from your analysis of the budget, all of that goes to deal with the subsidy rate change so that this entire presence around the country through the public-private partnership can continue to serve America's small business as well.

I would be very happy to respond to all of your questions.

[The prepared statement and attachments of Mr. Lader follow:]



U.S. SMALL BUSINESS ADMINISTRATION
WASHINGTON, D.C. 20416



STATEMENT OF

PHILIP LADER

ADMINISTRATOR

U.S. SMALL BUSINESS ADMINISTRATION

- With the downsizing of many large corporations, our nation's economic health will increasingly become tied to the health of small business.

What then does it take for today's small businesses to start, grow, and compete in the world economy?

When President Clinton named me Administrator he set out five goals for the SBA. In all my discussions with small business owners across the country, and in all that we have learned from studies, town meetings, survey after survey, and the White House Conference on Small Business process, those five goals continue to summarize how we can better serve the needs of small business:

- First, increase access to capital for small business owners, especially for those who need loans of \$100,000 or less and those who have been traditionally under-served, such as women and minority-owned small businesses and small exporters;
- Second, reinvent and reinvigorate the SBA to focus more effectively and efficiently on customer needs.
- Third, reduce burdensome regulations and unnecessary paperwork requirements that inhibit the growth of small businesses.
- Fourth, enhance small business education, counseling, and information for small business owners.
- Finally, serve as the President's "eyes and ears" with the small business community, and then serve as a strong advocate for the interests of that community.

SBA takes these goals very seriously. We remind SBA employees constantly of these goals and work on them daily. SBA has challenged itself to reach out to underserved segments of the small business community while managing an extraordinary growth in demand for virtually all of our programs. SBA today is delivering what our small business customers need and want.

Based on these goals, as the following accomplishments demonstrate, this is not, as I am fond of paraphrasing the automobile advertisement, "your father's SBA."

RECENT ACCOMPLISHMENTS

The past three years have been extraordinary ones for SBA. With fewer employees and resources, SBA is developing innovative and efficient ways of carrying out its programs in partnership with the private sector, state and local governments and our small business customers. In the past year, working closely with our partners, we have been meeting all five of our goals.

Goal: Increase access to capital for small business.

In 1995, SBA provided nearly \$11 billion in long-term credit and other financial assistance to more than 67,000 small businesses. With a business loan portfolio now exceeding \$26 billion, we are clearly improving the ability of small firms to gain access to the capital they need for survival and growth.

In our cornerstone program, the 7(a) Guaranteed Business Loan Program, approximately 7,000 private sector lending partners worked with SBA in FY 1995 to provide 55,596 loans worth \$7.8 billion to small business owners. That is an increase of 52 percent in the number of loans over FY 1994. Also in 1995, through 287 Certified Development Companies (CDCs) located nationwide, 4,509 Section 504 loans were approved totalling \$1.6 billion. That is an increase of 16 percent in the number of loans over FY 1994.

We are also excited about the revamping of our Small Business Investment Company (SBIC) Program. The new participating securities program is making patient capital available to small businesses, and our successful implementation of new regulations better protects against fraud and abuse while lowering the subsidy cost of the program to the taxpayers. Currently, the SBIC Program provides equity and venture capital to small businesses through 277 licensed SBICs. Over the past two fiscal years, SBA has licensed 57 new SBICs, representing approximately \$844 million in new capital, more than the previous 10 years combined.

During 1995, the SBA continued to expand several new business loan pilot programs designed to provide financing to segments of the small business community having difficulty obtaining credit.

- The Low Documentation (Low Doc) Loan Program has reduced the application for loans under \$100,000 to one page. In FY 1995, Low Doc provided 36,039 loans valued at \$2.1 billion.
- Our Women's Pre-Qualification Pilot Loan Program, which allows us to pre-qualify loan applications from women business owners prior to their submission to participating lenders, produced 338 loans worth \$35 million in FY 1995.
- In February 1995 SBA launched the FASTRAK pilot which allows certain participating lenders to approve, service and liquidate loans under \$100,000 using their own documentation. The SBA guaranty on these loans is limited to 50 percent. In FY 1995, FASTRAK resulted in 490 loans valued at \$23 million.

Also during FY 1995, SBA's Microloan Demonstration Program provided \$12.3 million to more than 1,200 small businesses located in nearly every state. With an average size of \$10,500, microloans provide the critical link for many of the very smallest businesses.

FY 1995 was the first year of SBA's new Export Working Capital Program (EWCP), under which SBA guarantees up to \$750,000 of loans made to small business exporters. During the fiscal year, 212 EWCP loans were made, valued at \$73.3 million.

FY 1995 also saw SBA implement the Defense Loan and Technical Assistance (DELTA) Program with the Department of Defense (DoD), in which SBA will guarantee almost \$1 billion of loans in FYs 1995 through 1998 to small businesses adversely affected by defense downsizing.

Goal: Reinvent and reinvigorate the SBA to focus more effectively and efficiently on customer needs.

SBA has become one of the Administration's most active agencies when it comes to reinvention. SBA is proud of its status as a volunteer pilot agency in implementing the Government Performance Results Act (GPRA), P.L. 103-62, which requires government agencies to develop goals beginning in 1997 which will be measured in terms of outcomes in addition to outputs (numbers).

For FY 1995, SBA once again used internal performance agreements containing lending and loan performance goals which are tracked throughout the year. As required by GPRA, SBA has included information on its success in this regard in our FY 1997 budget submission.

SBA has streamlined its ten regional offices from an average 34 employees per office to two or three, has closed ten post-of-duty offices, primarily through attrition and voluntary reassignments, and decreased our Washington Headquarters staff by 28% since 1992. SBA will continue to shift resources to our field offices to serve our customers better.

The Agency continued to expand the operations of its loan servicing centers in Fresno, California, and Little Rock, Arkansas. By the end of FY 1995, approximately 45% of all SBA disaster and regular business loans were being serviced in these centers. With limited exceptions, by the end of FY 1996 the centers will service our entire commercial portfolio.

Our Disaster Assistance Program is another success story. In FY 1995, SBA provided 45,041 loans worth \$1.2 billion to small business owners and homeowners who were victims of disasters. Forty-seven states received SBA disaster assistance last year.

The One Stop Capital Shop (OSCS) program brings SBA's lending resources into the Empowerment Zones and Enterprise Communities. Last year, SBA opened One Stop Capital Shops in Boston and Philadelphia. Kansas City's grand opening will take place later this month and the Kentucky Highlands OSCS is scheduled to open in June.

Goal: Reduce the burdensome regulations and unnecessary paperwork that inhibit the growth of small business.

In this area, SBA intends to be a role model for government. In the past year, SBA has reinvented 100 percent of its regulations, rewriting them in plain English and reducing their total pages by more than 50 percent. In the coming year, we are launching a similar effort to streamline some 25,000 pages of standard operating procedures and forms.

SBA also has played a central role in the Administration's regulatory reform efforts, working with EPA, OSHA, IRS and other federal agencies to address the regulatory concerns of small businesses. Using ideas resulting from SBA's outreach, President Clinton has directed federal agencies to waive penalties for first-time violations, cut paperwork, and streamline regulations.

To address the needs of small businesses for easy access to information, SBA has worked closely with the National Performance Review to pioneer the U.S. Business Advisor, a one-stop shop on the Internet for access to government information and regulations. This "Web" site is now generating more than 400,000 inquiries ("hits") per week.

Goal: Enhance small business education, counseling, and information.

In FY 1995, more than 900,000 small businesses received management counseling and technical assistance from SBA's resource partners, including 13,000 retired executives in the Service Corps of Retired Executives (SCORE) program and more than 900 Small Business Development Centers (SBDCs) and subcenters nationwide. SCORE, SBDCs and the Business Information Centers (BICs) provide training seminars and publications critical to the success of entrepreneurs who cannot afford the cost of private consultants. SBA opened BICs in ten cities in FY 1995, bringing the total number of BIC program sites to 27 nationwide.

SBA has also worked to provide training to small businesses on Electronic Commerce (EC) and Electronic Data Interchange (EDI). This training helps businesses learn about new federal procurement initiatives at minimal cost.

Goal: Serve as the President's "eyes and ears" with the small business community.

In 1995, small business owners and entrepreneurs from across the country came together for the White House Conference on Small Business in order to identify the problems of small businesses and develop recommendations for executive and legislative action to maintain and encourage the economic viability of small businesses.

Already, the Administration has implemented (often with the help of Congress) more 1995 Conference recommendations than were implemented after both the 1980 and 1986 conferences combined. Through its Office of Advocacy, SBA is working with Conference delegates to implement as many recommendations as possible through legislative and administrative action.

FY 1997 BUDGET REQUEST

The President's request for the SBA for FY 1997 is \$808.4 million. It reflects the President's recognition of the role that small businesses play in our nation's economy, and it evidences his strong, continued commitment both to small businesses and to a reinvigorated SBA as the vehicle to support and assist them. Yet SBA's budget takes into account the need to be streamlined and, as I told you last year, to do more with less. It is worth noting that this year's entire FY 1997 budget is less than one-half of the taxes paid by one SBA-assisted company, Intel, Inc., over a two-year period (1994-1995).

CREDIT AND FINANCE PROGRAMS

As you know, the SBA expands access to capital by providing credit, through thousands of financial intermediaries, to small businesses unable to obtain loans needed to start-up or expand. Traditionally, small firms have faced serious problems obtaining long-term loans in the private credit marketplace because lenders try to avoid mismatches of long-term assets with their mostly short-term liabilities. The SBA, however, has helped to alleviate this problem by providing loan guarantees to participating lenders under a variety of programs.

Subsidy Rate Study

Let me take a moment at this point to talk about the Administration's budget proposal as it concerns subsidy rates.

Under Title V of the 1974 Budget Act, the SBA and all other credit agencies must annually re-estimate subsidy rates using an historical analysis. In March 1995, pursuant to the Act and at my specific request, SBA and the Administration began to undertake what we believe is the most comprehensive analysis of a loan portfolio of any major credit agency. The results of this analysis have led to a revision of the subsidy rates for all of our credit programs. Subsidy rates for the 7(a) and 504 programs were increased, principally because the repurchase of defaulted loans and the recovery rate from those repurchases were considerably different than what had been projected in earlier years. At the same time, subsidy rate for SBICs, disaster loans, and Microloans have been reduced.

The goals of the Loan Performance Study (LPS) Project were to build a comprehensive loan performance database allowing for: the analysis of loan performance based on multiple risk indicators; the updating of FY 1997 subsidy rate estimates using historical performance as a base; and the ability to annually review past subsidy rates comparing actual performance with previous estimates. In the study, historical cash flows were tracked on a loan-by-loan basis at the most detailed level, allowing for the review of historical performance by multiple loan characteristics such loan size, maturity, and guarantee percentage.

This comprehensive study reviewed more than 600,000 loans and 25 million transactions in SBA's business and disaster loan programs during the period from 1983 through the end of FY 1995, the period for which historic loan data is available. It is the most complete analysis since the enactment of the Credit Reform Act in 1990.

We concluded that these loan guarantees were "a good deal" for Americans then, and they still are. But our findings, as a result of conservative, responsible management, require that these programs' subsidy rates be raised. This increase in the subsidy rates represents a correction in the course set in 1991 when SBA's first subsidy rates were established. We are aggressively moving forward in strengthening those areas that will assist us in lowering the subsidy rate in subsequent years. And given the likely better performance of loans made in more recent years, the subsidy rate can probably be reduced over time.

Liquidation Improvement Project

SBA is committed to assuring the quality of all aspects of its loan operations. Therefore, when our exhaustive study of the SBA loan portfolio showed that its performance did not match the Agency's previous estimates and expectations regarding repurchase and recoveries, we initiated a Liquidation Improvement Project, jointly headed by one of the Agency's Regional Administrators, the Acting Associate Deputy Administrator for Economic Development, and the Associate Administrator for Field Operations working with a team of field and headquarters staff.

As part of this liquidation improvement project, SBA recently convened two working groups to look at the Agency's practices and procedures for liquidating 7(a) and 504 loans. One of these groups focused on the internal steps which can be taken by field office staff to reduce the length of time it takes to liquidate a loan and to increase the recoveries of loans in liquidation. The second group looked at SBA's automated systems to find ways to improve data collection and reporting. Each group developed a list of short, intermediate, and long term changes designed to improve the Agency's handling of liquidation activities.

I have contacted all field offices to stress the importance of the Liquidation Improvement Project. By improving SBA's liquidation activities, the Agency should see a decrease in SBA's subsidy rates. We consider this initiative to be one of the Agency's highest priorities.

The efforts of the Liquidation Improvement Project team complement earlier efforts to evaluate alternate loan liquidation activities. Last October, SBA contracted with an experienced and highly regarded assets management firm to look at possible options for disposing of loan collateral. The final report under this contract should be completed in the next 60 to 90 days.

7(a) General Business Loan Guarantee Program

In its Section 7(a) general business loan guaranty program, SBA guarantees loans made by private lenders to small firms for working capital, start-up costs, expansion, and other purposes. The Administration's portfolio analysis indicates that actual recoveries and defaults, as well as the timing of such events, have differed from estimates used in previous years. Therefore, the baseline subsidy rate for the 7(a) program was adjusted from 1.06% to 2.68%.

The FY 1997 budget request includes an appropriation for the 7(a) credit subsidy of \$294.8 million, which would support a program level of \$11.0 billion for FY 1997. It is important to note that the Administration is requesting that the program continue to grow to meet the unprecedented demand for small business loans, but we are requesting no programmatic changes for the 7(a) program in FY 1997. Additionally, the cost of the program to small business borrowers and to SBA's lending partners will not change.

Although the subsidy rate increase results in a need for more credit subsidy funding, the Administration is committed to making sure small businesses can continue to gain access to capital that they need to start and expand their operations. We feel strongly that the 7(a) program needs to be supported at the \$11 billion level, and therefore, we have requested the necessary funding in the budget.

It should be noted again that the analysis points to an improvement in the 7(a) portfolio quality since 1993. Loans made over the past several years have shown a lower incidence of defaults. If these positive trends continue, as we believe they will, the 7(a) subsidy rate will begin to decline next year with subsequent reductions to follow for as long as the portfolio quality improves and portfolio management capabilities are maintained.

SBA's budget request reflects our intention to continue existing pilot loan programs in FY 1997. These programs were developed to provide greater access to financing for underserved segments of the small business community. As noted above, these include the Women's and Minority Pre-qualification Pilot loan programs, and the Low Doc and FASTRAK programs.

Certified Development Company (504) Program

The Section 504 Certified Development Company (CDC) Loan Program provides long-term, fixed-rate financing to small businesses to acquire real estate, machinery, and equipment for expansion of business or modernizing facilities. Through this program, the Agency promotes economic development and job creation by stimulating the flow of long-term financing to small firms for projects that involve fixed assets or expansion.

For the Section 504 Certified Development Company program, SBA is requesting a \$2.65 billion program level.

The Administration's portfolio analysis indicated that previous estimates of recoveries in the 504 program were higher than SBA's actual recovery rate and that previous estimates of defaults were lower than the historical defaults used to calculate subsidy costs. Consequently, the baseline (current services) subsidy rate for the 504 program has been adjusted from 0 to 6.85%. To keep the 504 subsidy rate at zero in FY 1997, the Administration is requesting legislation to transform the Section 504 program's funding mechanism by providing funds from the Treasury, rather than through the sale of debentures to the public.

Under this proposal, SBA would lend directly to Certified Development Companies, rather than guaranteeing their debentures. This change would eliminate the need for underwriters and other financial intermediaries and transfer the existing fees paid by the small businesses to the SBA, resulting in a 0% subsidy rate. Importantly, these changes would not increase the cost of capital to the Certified Development Companies and would not increase the cost of borrowing to small businesses or the risk to U.S. taxpayers.

We look forward to working with you to make this legislative adjustment a reality, particularly in light of your own focus on achieving cost savings.

On the assumption that we can revise the funding mechanism, the Administration requests no appropriation for subsidizing the 504 Program. It will remain a self-funding program as the Congress intended in its 1995 legislation (P.L. 104-36).

Small Business Investment Company Program

The Small Business Investment Company (SBIC) program is an important source of equity and subordinated debt financing for small businesses. The program provides SBA-backed funds to supplement private capital raised by private sector venture capital companies. These combined funds represent an important source of capital for growing small businesses.

Since the restructuring of the program in 1994, SBA has experienced a huge increase in demand for SBIC leverage. As I said earlier, during the last two fiscal years, 57 new SBICs have been licensed, bringing \$844 million of private capital into the program. This is as much private capital as that raised by the program in the preceding 10 years.

To meet the increasing demand for SBIC leverage, SBA is requesting a \$21.7 million appropriation to support the SBIC debenture and participating securities guarantees. Of this amount, \$8.2 million would support SBIC debenture guarantees of \$225 million and \$13.5 million would support participating securities guarantees of \$400 million.

These amounts represent a significant increase in the guaranty level for SBICs while concurrently reducing the costs to the taxpayer. The \$225 million guaranty for debenture funding will more than double the program level from FY 1996 levels, while the \$8.2 million appropriation is a reduction of almost 50 percent over the same period. The proposed \$400 million authorization for participating securities is a 50 percent increase in program level with a 44 percent reduction in appropriations to \$13.5 million as compared to FY 1996.

In order to reduce the program's subsidy cost, SBA is proposing a legislative change that provides for SBICs to pay slightly more for their SBA leverage in FY 1997. The current two percent funding fee (three percent if a commitment is used) will be increased to three percent for all funding, and an annual one percent fee will be established on the outstanding loan balance. These actions are consistent with the recommendations of the industry-led SBIC Reinvention Council, which proposed program reforms in its 1995 report. These charges will reduce the subsidy rate of the SBIC debenture program from 15.46% in 1996 to 3.65% for 1997, and in the SBIC participating securities program from 9.0% percent in 1996 to 3.38% in 1997.

In keeping with our efforts to improve the management of the SBIC program, we have contracted out, or "outsourced," a substantial portion of our SBIC liquidation activities. Currently, SBA uses self-liquidation agreements and receiverships to augment resources on 62% of the SBIC liquidation activity. That percentage will increase to 75% once the procurement process for four additional contracts with the private sector is complete. Also, SBA is in the process of procuring a contract to review the feasibility of privatizing the licensing and examination of SBICs.

Microloan Program

SBA is requesting \$5.1 million for the Microloan Program, which will support a \$62 million program level including both direct loans and guarantees. The microloan subsidy rates for FY 1997 were also adjusted to reflect actual performance. The rate has been decreased from

15.69% to 8.20% for direct microloans and from 11.95% to 8.43% for guaranteed microloans. We are also requesting \$15.4 million for related technical assistance. This program allows SBA to provide loans and technical assistance grants to non-profit intermediaries. The intermediaries, in turn, use these funds to provide loans in amounts up to \$25,000 and technical assistance to individual small business owners.

The microloan pilot is allowing SBA to evaluate the effectiveness of using third-party, experienced lenders and technical assistance providers to make smaller loans and provide technical support to small businesses with very modest borrowing needs. The program's great strength is the technical assistance that SBA grant funding provides for the small businesses.

Surety Bond Guarantee Program

SBA is requesting \$3.7 million in new budget authority to support \$1.76 billion in guarantees for the Surety Bond Guarantee (SBG) Program, under which SBA guarantees bonds that are issued by surety companies on behalf of small contractors. The SBA guarantees up to 90 percent of losses incurred on bonds for construction, service and supply contracts of \$1,250,000 or less that are performed by small businesses.

In FY 1995, through the SBG Program, SBA helped contractors obtain 6,807 contracts, totalling \$1.2 billion in contract value. SBA estimates that 58,000 jobs resulted and savings of \$80 million for taxpayers were realized through SBA-guaranteed bonding of low bidders.

Disaster Loan Program

The SBA's disaster loans are the primary form of Federal assistance for non-farm, private sector disaster losses. For this reason, the program is the only form of SBA assistance not limited to small businesses. Disaster loans from the SBA help homeowners, renters, businesses of all sizes and non-profit organizations fund rebuilding. The SBA's disaster loans are often the lifeline in disaster-ravaged communities, helping to spur employment and stabilize the tax base. During the program's 41 years, the SBA has approved more than 1.23 million disaster loans worth \$25 billion to victims of physical disasters. In FY 1995, over 75% of these loans went to homeowners and non-business borrowers.

In her March 14 letter on views and estimates to the House Budget Committee, Small Business Committee Chair Jan Meyers recommended restricting disaster lending and the posting of SBA disaster personnel to a maximum 24 months after the initial disaster declaration. The goal of SBA's Disaster Assistance Program is to serve the disaster victim in the most effective and efficient manner within SBA's statutory authority. In almost every instance, SBA completes its work on any given disaster long before 24 months have elapsed. There are circumstances, however, where 24 months is not long enough, both for SBA borrowers and for U.S. taxpayers.

For instance, SBA has been called upon to respond to mega-disasters, such as the 1994 Northridge earthquake, where the sheer magnitude of the damage is such that SBA's operation could not be completed within this time frame. A 24-month time limit would force SBA to make

disaster payments in a lump sum. Currently, SBA disaster payments are disbursed serially, which ensures that loan money is only provided to disaster borrowers if it is actually needed. Many times, after a loan has been approved, actual repair costs are less than estimated, or private insurance pays for more of the damage than anticipated. In these instances, the borrower does not require the entire amount for which the loan was originally approved.

As for servicing loan activities, SBA has already achieved economies of scale by centralizing disaster home loan activities at four sites. However, as this Committee has indicated, SBA must continue to look at ways to further reduce the costs related to disaster loan servicing. That is why on February 16, 1996, SBA published a Federal Register Notice requesting comments from the public regarding the most efficient method of handling the servicing and collection functions of these loans at a cost consistent with, or below existing levels. The closing date for comments has passed and SBA is reviewing the comments received.

Given rising Federal costs resulting from the tremendous level of disasters experienced over the past six years, the Administration is proposing a legislative change to adjust the disaster loan interest rates to the Treasury cost of funds for securities of similar maturity. At the program's current interest rate of roughly four percent, the Government is indirectly providing a disincentive for individuals to insure adequately against natural disasters. Accordingly, it is vital to bring the interest rates charged for these loans more in line with market rates.

Due to the large subsidy inherent in the interest rate charged the disaster borrower, declining interest rates caused the subsidy rate to decline from 28.08% to 16.21% in FY 1997. The Administration is proposing a legislative change to increase the interest rate charged the borrower to the Treasury cost of funds for securities of similar maturities (currently estimated at 5.49% for FY 1997). The subsidy rate would be further reduced from 16.21% to 7.9% under this proposal. The SBA's budget request, therefore, is for \$65.8 million in subsidy budget authority to support a program level of \$833 million (the ten-year average excluding the Northridge disaster), and \$27.6 million for administrative expenses.

Due to the unpredictable nature of this program, the annual loan program level and costs associated with this program cannot be precisely estimated. As a result, the Administration relies on the use of carry-forward balances and recoveries from previous years, as well as contingency appropriations. For FY 1997, the SBA has included a request for a \$100 million contingency appropriation to address this uncertainty.

BUSINESS EDUCATION AND TRAINING

Small Business Development Center Program

The Small Business Development Center (SBDC) Program, created by the Congress in 1980, has one unifying purpose: to foster economic development through the provision of management, technical and research assistance to the nation's small businesses. By virtue of

their counseling, training and specialized services offerings, SBDCs help to save companies and jobs, create new jobs through business expansion, stimulate lending that results in increased production, and assist businesses in surviving industry or sector downturns.

For FY 1997, the Agency is requesting an appropriation of \$72.3 million for the SBDC Program and is proposing an enhancement of services to small businesses by integrating both the Women's Demonstration Program and the 7(j) Technical Assistance Program into the Small Business Development Centers.

The Administration submitted legislation during the first session of the 104th Congress to make the changes necessary to streamline the administrative process to carry out this proposal. SBA will resubmit this legislative request to the Congress. Additionally, SBA has requested that the prohibition against SBDC's charging fees be permanently repealed by the Congress. The prohibition was lifted in the Conference Report to the FY 1996 Commerce, Justice, State, Judiciary and Related Agencies bill. The Administration continues to support this proposal.

Business Information Centers

For FY 1997, SBA is requesting \$485,000 for the Business Information Center (BIC) program to expand the number of BICs nationwide. BICs combine the latest computer technology, hardware and software, an extensive small business reference library of hard copy books and publications and management videotapes to help entrepreneurs plan their business, expand an existing business or venture into new business areas. The use of software for a variety of business applications offers customers of all types a means for addressing diverse needs. In addition to the self-help hardware, software and reference materials, BICs have on-site counseling provided by SCORE volunteers and other resource partners. The Business Information Centers are one of our most innovative methods of providing a one-stop approach to information, education and training for small business owners.

Service Corps of Retired Executives (SCORE)

SBA is requesting an appropriation of \$3.25 million for the SCORE Program. SCORE counsels and trains the largest number of start-up business owners each year. Through one-on-one counseling and workshops conducted by 13,000 volunteers, SCORE reaches approximately 350,000 business owners annually.

U.S. Export Assistance Centers

SBA is requesting \$3.1 million of funding in FY 1997 for the U.S. Export Assistance Centers (USEACs) which provide U.S. exporters with information and access to all export promotion and export finance activities of the Federal Government. In FY 1995, in partnership with the Department of Commerce and the Export-Import Bank, SBA opened eight new USEACs, for a total of 14 USEACs providing loan guarantees and technical assistance to small business exporters across the country.

One-Stop Capital Shops

This initiative combines several of SBA's economic resources into a single program to be used in tandem with Empowerment Zones and Enterprise Communities. Combining the delivery of the Agency's financial and business development programs at one location provides more user-friendly and streamlined approach to servicing our customers. SBA is requesting \$2.7 million for the One-Stop Capital Shops for FY 1997.

SMALL BUSINESS ADVOCACY

Government Contracting and Minority Enterprise Development (MED)

Through MED, SBA assists businesses owned and controlled by socially and economically disadvantaged individuals to be more successful in the mainstream national economy. Through the award of sole-source and limited-competition contracts, MED provides a way for small businesses owned and controlled by economically and socially disadvantaged individuals to access market growth opportunities.

SBA is requesting \$9.8 million for MED in FY 1997, an increase of \$5 million from this year to improve processing of 8(a) applications and determinations of small disadvantaged business status. These additional funds will be used to increase program automation, enabling staff to devote more time to providing hands-on business development assistance to participating firms. Finally, these funds will provide for the expansion of the executive development program through the 7(j) technical assistance program to help a greater number of program participants achieve full competitive viability.

Office of Government Contracting

SBA is also requesting an \$11.3 million appropriation for the Office of Government Contracting (OGC). This includes \$9.2 million for field area offices to deliver the procurement programs and \$2.1 million at the central office for the crafting of procurement policy and legislative changes affecting the small business community. The \$11.3 million is an increase of \$257,000 above the fiscal year 1996 conference level. This level of funding is necessary to promote new technology and training for small businesses in electronic commerce and electronic data interchange.

It is important to the small business community that SBA continue to aggressively pursue its mandate to ensure access to opportunities for government contracts and subcontracts. Each year, these opportunities result in billions of dollars in contract and subcontract awards to small business firms.

Office of Technology

The Office of Technology (OT) promotes an accessible market for small, high-technology businesses to participate in satisfying the research and development needs of the federal government. To accomplish this objective, OT provides strong, coordinated leadership to the small business technology sector. The office places particular emphasis on directing the interagency effort which delivers the Small Business Innovation Research (SBIR) and Small Business Technology Transfer (STTR) programs. Recognizing the quantum leap that high technology is taking in this decade, the focus of the OT on maximizing federal and small business participation is important to small business.

In FY 1997, the SBIR program's legislated goal for small business will be 2.5 percent. This level will result in awards to small business totalling approximately \$1.2 billion.

The SBIR program is currently authorized through FY 2000. However, the STTR program will expire September 30, 1996 based on its enabling legislation. Authorization legislation (H.R. 3158) was recently reported out of the House Small Business Committee to extend STTR program authority to coincide with the SBIR program, through the end of FY 2000.

Office of Advocacy

The SBA will continue to strive for a positive economic and less government-intrusive environment for small business. To accomplish this objective, we will continue to work to reduce unnecessary regulation and paperwork, examine existing Federal programs, and identify the problems of small businesses and recommend solutions. Through our Office of Advocacy, we want to live up to SBA responsibility as the voice of small business in the Executive Branch. SBA has requested \$5.2 million for the Office of Advocacy in the FY 1997 budget.

IMPROVING OPERATING EFFICIENCIES

Streamlining Operations

The Budget assumes a continued commitment to Agency reinvention efforts aimed at streamlining our operations both in the field and at the Washington, D.C. headquarters. In addition, we intend to build upon recent successes realized from improvements in the delivery of agency programs. Implementation of the Low Doc program and establishment of centralized loan servicing centers have improved operating efficiencies while dramatically enhancing the level of satisfaction of the Agency's small business customers. Improved currency rates in the repayment of SBA loans are another tangible consequence of these management changes.

SBA is also improving its efficiency in the business loan processing function. During FY 1995, we centralized the processing of Preferred Lender Program (PLP) loans in our Sacramento Loan Processing Center. This unit takes advantage of automated systems and economies of scale to assure consistent delivery of the PLP program and high quality customer service. Thus far,

in FY 1996, 37 percent of the total dollars of 7(a) loans processed, and 19 percent of the total number of loans processed, have been through the PLP program. This compares with 16 percent of the total dollars, and eight percent of the number of loans in FY 1995. This change can be attributed directly to the legislation passed by the Congress last year (P.L. 104-36), which eliminated the disincentive for banks to use the PLP program.

By the end of FY 1996 we expect our loan servicing centers to service SBA's entire portfolio of current commercial loans. This will greatly improve agency operations by utilizing automation and creating economies of scale, as well as improve the quality of service to our customers.

Regular Salaries and Expenses

Funding for salaries and expenses reflects our ongoing initiative to serve our customers more efficiently and effectively and to save taxpayer dollars. The SBA recently completed a two-phase program which moved personnel from our headquarters and regional offices to various district offices close to our customers. To date, more than 200 employees have voluntarily moved to district offices. Since 1992, SBA's overall non-disaster and non-OIG staff has been reduced by 21.2 percent; and in the same period, headquarters staff has been reduced 28 percent. In the 18 months since I have been Administrator, moreover, our headquarters staff has been reduced 18.5 percent. The Agency expects to continue its efforts to streamline its operations.

The budget request for salaries and expenses (excluding OIG and disaster employees) is \$383.2 million, which will fund 3,122 full-time equivalents (FTEs).

OFFICE OF INSPECTOR GENERAL

The Office of Inspector General (OIG), as an independent office within the SBA, conducts and supervises audits and investigations of SBA programs and operations. This office also detects and prevents fraud, waste and abuse, and promotes policies for improvement of economy, efficiency, and effectiveness in the administration of SBA programs and operations.

The budget request for the OIG is \$10.0 million to fund 109 FTEs. This amount includes a current operational level of \$9.5 million, and \$500,000 to fund the 14 temporarily-appointed disaster employees currently funded by \$3 million of no-year funding that expires in FY 1997.

The Agency, and I personally, fully support this request as being essential to fund critically needed OIG audits, investigations, and inspections -- all of which save Federal dollars, deter further violations of law, and help ensure SBA's positive impact on the small business community. An adequately-funded OIG is even more important as the Agency's loan portfolio expands.

CONCLUSION

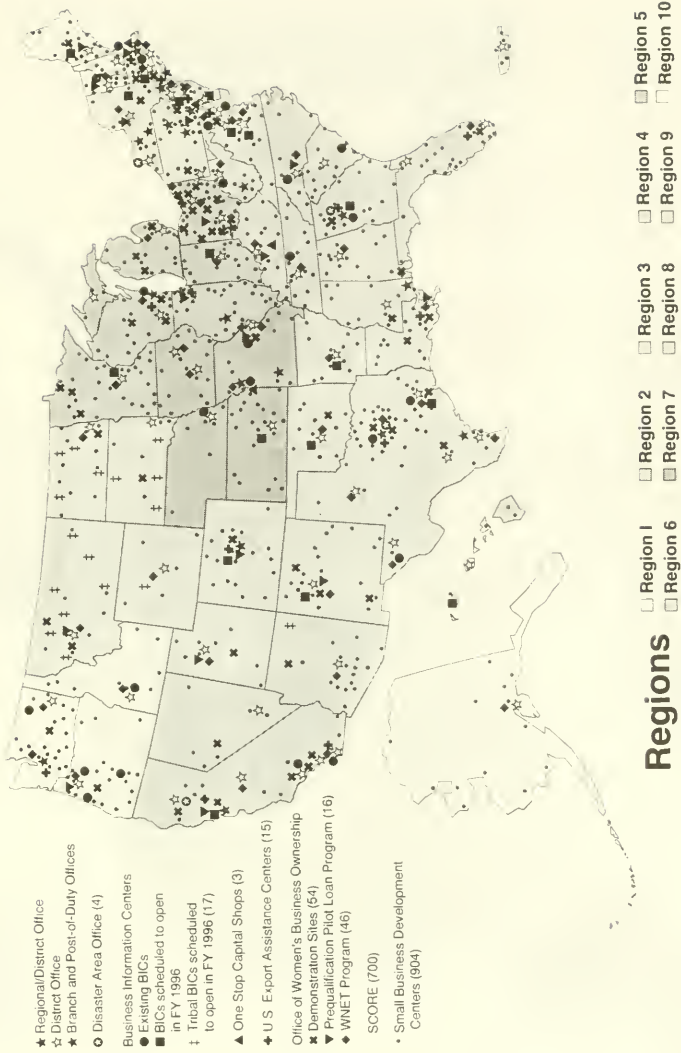
Mr. Chairman, the 1997 Budget reflects the President's strong commitment to the nation's small firms and to a reinvigorated Small Business Administration. By seeking to expand the capital market frontier for small firms, we are continuing SBA's original purpose of helping to ensure that viable businesses and innovative entrepreneurial ideas -- which otherwise would not be able to obtain long-term financing or patient capital -- are funded.

SBA's five goals -- increasing access to capital; reinventing the SBA to better serve its customers; reducing the burden of regulations and paperwork; enhancing education and training to small business; and being the President's "eyes and ears" in the small business community -- continue to guide both this Budget and our daily work.

We look forward to working with you and the Congress in 1996 to ensure that America's small businesses prosper.



U.S. Small Business Administration and Partners Services Delivery Network



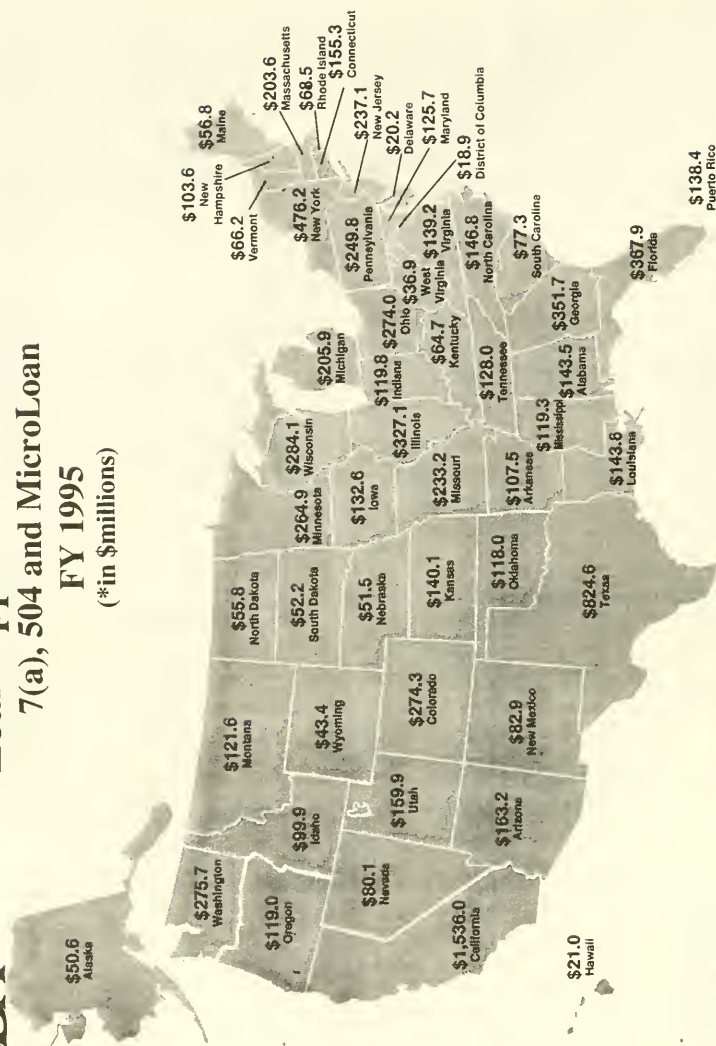


Loan Approval Amounts*

7(a), 504 and MicroLoan

FY 1995

(*in \$millions)

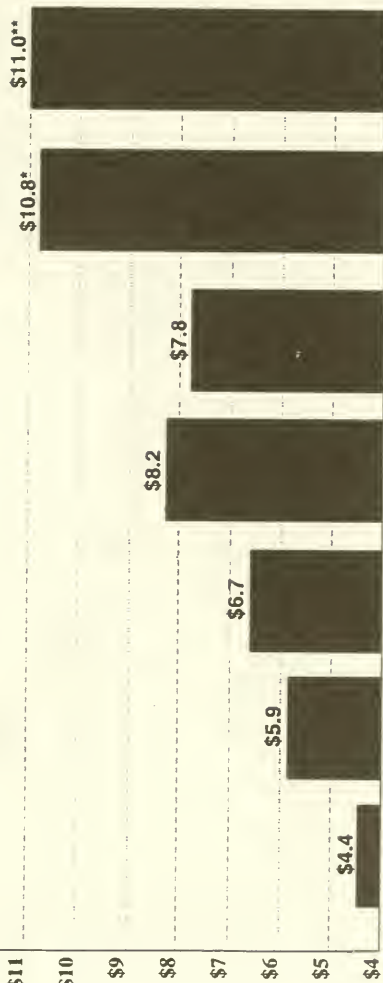


(4/29/96)



7(a) Loan Activity FY 91 ~ FY 97

Dollars
in Billions



Number of Loans

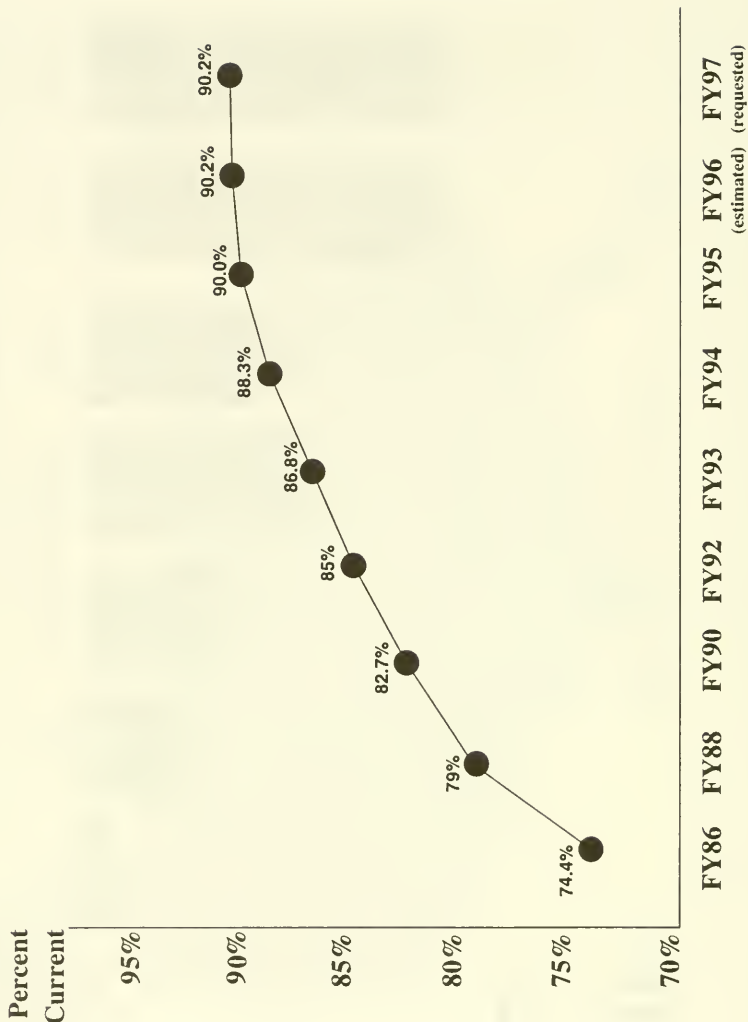
FY91	FY92	FY93	FY94	FY95	FY96	FY97
19,056	24,284	26,811	36,480	55,596	68,800	70,000

* Represents appropriated program level in FY96

** Requested appropriated program level for FY97

Profile of 7(a) Loans

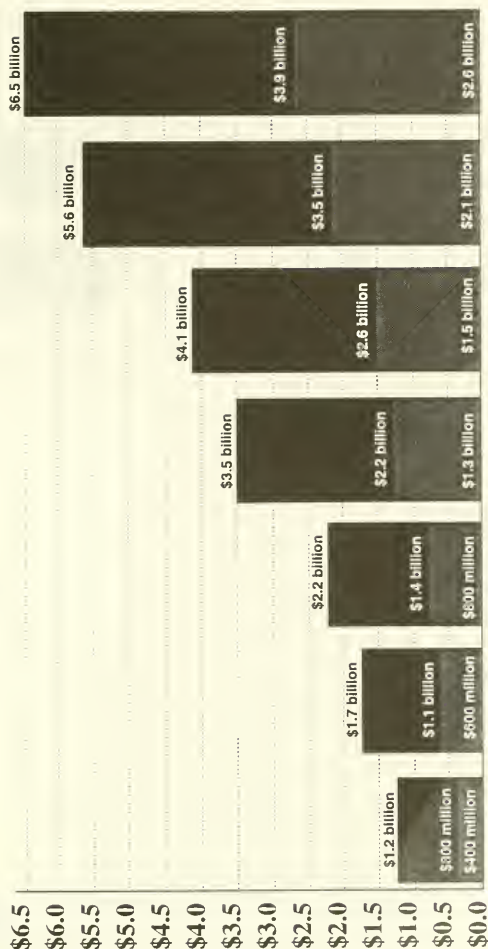
Percent Current





504 Assisted Projects FY 1991 to FY 1997

\$ Billions



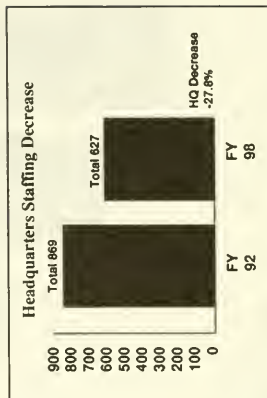
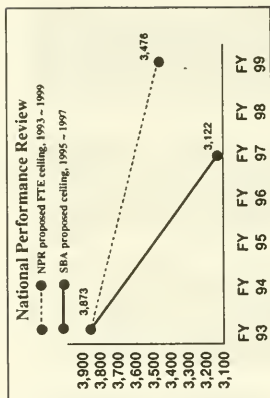
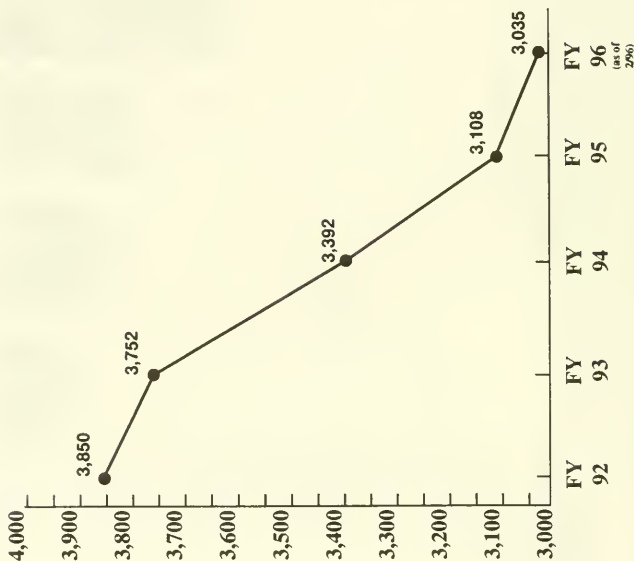
Cost to taxpayer

Private Sector – represents commercial lending (non-federal funds) and borrowers equity

504 Project – SBA guaranteed amount

Employees (Excluding IG and Disaster)

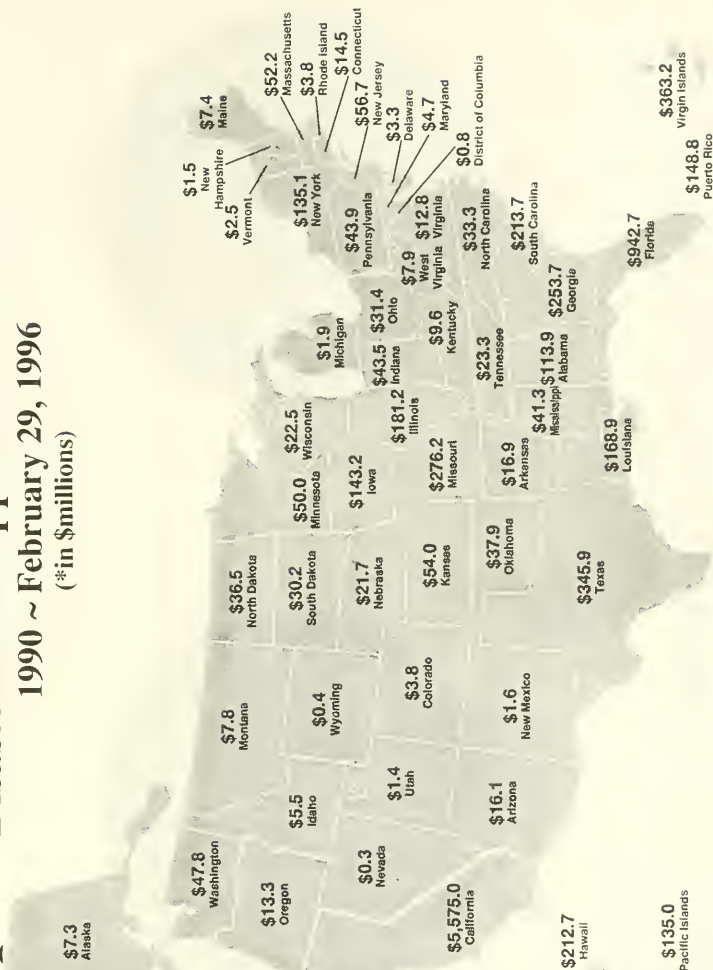
Number of
Employees



Disaster Loan Approval Amounts*

1990 ~ February 29, 1996

(*in \$millions)





Disaster Loan Activity

FY 1995

(Original approvals)

Number
45,041

\$ Millions
\$1,217.4 million



Home

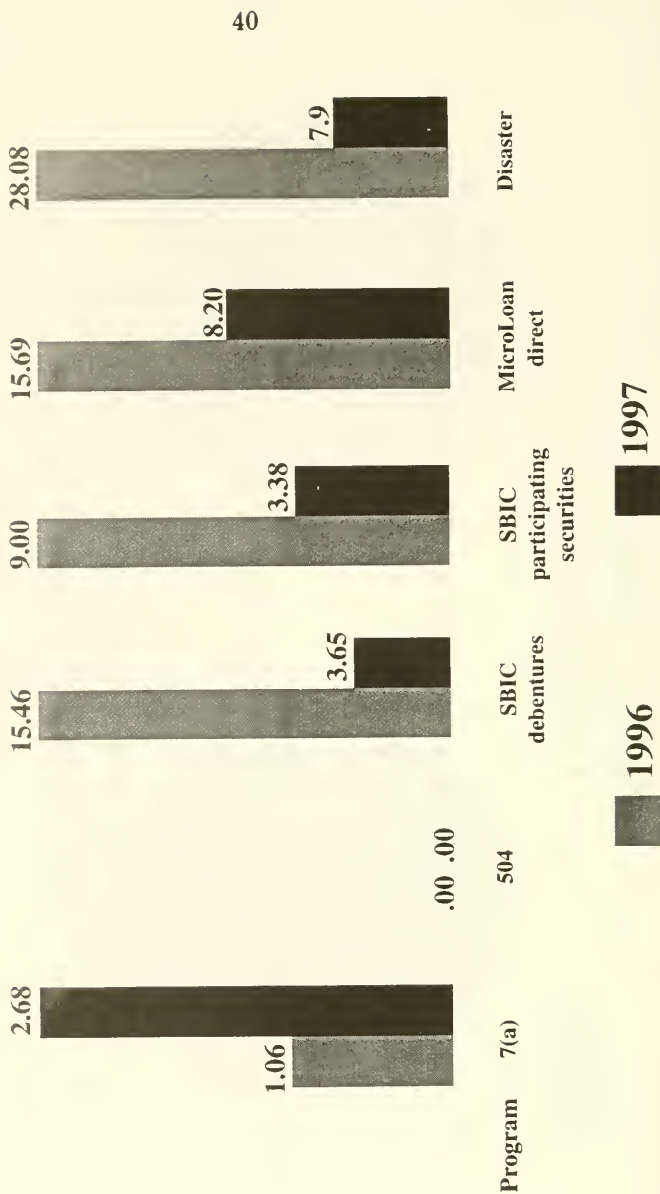
Business and EIDL

- ★ Most comprehensive review of loan performance by a major credit agency
- ★ 600,000 loans/25 million transactions reviewed
- ★ Loans from 1983 through 1995 reviewed
Early cohorts/Projected recoveries
- ★ Legislative/Administrative improvements



Program Subsidy Rates

1996 vs. 1997 levels



Chairman BOND. Thank you very much, Mr. Lader. We have been joined by our distinguished ranking member. Before turning to Ms. Lew I would like to call on Senator Bumpers for comments he would like to make, either with regard to Ms. Lew or the budget.

Senator BUMPERS. Mr. Chairman, I have a prepared opening statement dealing with both Ms. Lew, whom I warmly and strongly support, and the budget. In the interest of time I will be happy to submit those for the record.

Chairman BOND. They will be accepted. Thank you very much, sir.

[The prepared statement of Senator Bumpers follows:]

PREPARED STATEMENT OF SENATOR DALE BUMPERS
COMMITTEE ON SMALL BUSINESS
MAY 1, 1996

Mr. Chairman, I would first like to commend you for scheduling this hearing on the nomination of Ginger Lew to be Deputy Administrator of the Small Business Administration and also to consider the President's FY 1997 budget proposal for SBA.

I have met with Ms. Lew and am extremely impressed with her credentials and with her personally. Ginger Lew has extensive experience in business, law, and international trade. She has served as General Counsel for the Commerce Department and was Deputy Assistant Secretary of State in the Carter Administration. She has also helped launch a bio-mass technology firm in California. All of these are excellent experiences for the post of Deputy Administrator. I strongly support her nomination and hope the Committee will act favorably on her nomination -- today if at all possible.

As to the President's budget request for SBA, it bears mentioning that President Clinton has made the Small Business Administration a vital part of the Federal government for the first time in many years. This President has chosen some of the most highly qualified individuals in the business world to run this agency. He has included Administrator Phil Lader and his predecessor Erskine Bowles in the highest councils of policy making. And, perhaps most importantly, the Clinton Administration has changed the face of SBA lending. SBA now makes far more loans to far more people than ever before. In short, the renewed SBA has gone from being a political graveyard in the '80s to one of the most vibrant and hardworking agencies of the Federal Government, today.

It is an unpleasant fact that the cost of the largest SBA loan guaranty programs, Sec. 7(a) guaranteed bank loans and Sec. 504 economic development loans, have been sharply increased in the '97 budget. These increases, which will be the subject of extensive discussion today, are based on a very large and impressive study of SBA lending undertaken by SBA and OMB -- the first such comprehensive study since the passage of the Credit Reform Act of 1990. We may not like these increases, but Credit Reform is a reality which we must face.

It is also a fact that President Clinton has submitted by far the strongest SBA budget request of any President in memory. He strongly supports SBA's role in the economy, and he has put up the money to pay for it. This budget tests whether we who say we support these same programs are also willing to pay the cost. Although the increase in the subsidy scoring of the 7(a) program is very frustrating to me, the new scoring is not out of line with historical costs of the program. The 7(a) program remains a bargain for the Congress and for the country.

I must say that the 504 program presents a different set of issues. That scoring increase -- from zero to 6% -- raises disturbing questions, and I am not yet comfortable with the proposed solution. Suffice to say that there were policy decisions made under previous Administrations which I find difficult to comprehend -- specifically, the "off budget" treatment of the liquidation accounts known as "memorandum accounts." It could well be argued that SBA in following this practice was creating money without authorization or appropriation. These liquidation accounts allowed the reported cost of the program to appear unrealistically low. This practice will be stopped by the new budget scoring.

The Administration proposes to convert the 504 program from a loan guaranty which is now financed on Wall Street to a direct loan program through the Treasury's Federal Financing Bank. This change goes against the general trend of loan guarantees rather than direct lending. Frankly, we do not yet have a solution to this vexing problem. I still strongly support the goals of the 504 program which provides long-term, fixed rate financing to businesses seeking to buy plant and equipment. In today's budget climate, however, a 6% subsidy cost is not acceptable.

I also have some doubts about the proposal to combine several small business assistance programs with the Small Business Development Center program but not increase the SBDC funding to accommodate the change. Generally speaking, however, I support most of the Administration's budget for SBA. I believe we will be able to resolve these differences before the end of the fiscal year as to avoid another disruption of services to the small business community.

Chairman BOND. Ms. Lew, welcome, and you may proceed with your statement.

STATEMENT OF GINGER EHN LEW, NOMINEE TO BE DEPUTY ADMINISTRATOR OF THE U.S. SMALL BUSINESS ADMINISTRATION, WASHINGTON, D.C.

Ms. LEW. Thank you, Mr. Chairman. Mr. Chairman, Senator Bumpers, Senator Kempthorne, and members of the Committee, I am deeply honored to appear before you today as President Clinton's nominee for the position of deputy administrator. Let me thank you, members of the Committee, and your staff for the assistance shown during this confirmation process by scheduling this hearing so soon after my nomination.

I appreciate the generous introductions of Congresswoman Pelosi and Administrator Lader, and am grateful for their friendship and support. I would also like to thank the Congressman from my home district, Congressman Bill Baker, who graciously offered his support for my nomination.

I would like to express my gratitude for the support of my family, some of whom are here today. If I may, Mr. Chairman, I would like to introduce them.

Chairman BOND. Would you, please?

Ms. LEW. This is my husband, Lennart Ehn; and my aunt, Mrs. Fay Lee, and my cousins, Mrs. Judy Lee and Mrs. Helene Eng who are here from San Francisco. I would like to take a special moment to express my heartfelt thanks to my husband who has been very supportive and encouraging of me and my career, especially as I have traipsed across the United States several times.

Mr. Chairman, I believe my background and professional experiences will hold me in good stead as deputy administrator, if confirmed. I have spent 21 years in both the public and private sectors which has given me a broad range of business and management experience.

As Congresswoman Pelosi mentioned, the deputy administrator is the chief operating officer of the agency, with primary responsibility for the day-to-day operations. My previous management experience in Government will enable me to be an effective and hopefully, strong deputy. As regional chief enforcement counsel for the Department of Energy, I managed a staff of attorneys and legal professionals in field offices throughout a 10-State region.

During my tenure as Deputy Assistant Secretary of State for East Asia I gained further management experience overseeing personnel and operations offices around the Pacific Rim. Most recently as the general counsel for the U.S. Department of Commerce I had not only management responsibility for attorneys, I also had department-wide operational responsibilities throughout the United States and overseas.

I have more than 8 years of experience in the private sector with advising companies, both large and small. As a principal with Arthur Young & Company, I helped numerous small and emerging companies expand into international markets by identifying market opportunities, structuring transactions and locating financing sources. As vice president of a startup, high tech company I encountered firsthand the many challenges all small businesses face:

getting access to capital; and complying with a myriad of Federal, State, and local regulations, including multiple reporting requirements and recordkeeping.

I applaud the significant regulatory reform efforts undertaken by the SBA to date, and believe we must continue to advocate for changes within SBA, as well as with other agencies, to find ways to relieve the regulatory burden on small businesses and to allow them to get on with the business of doing business.

My hands-on experiences have also taught me that it is essential that we maintain a close and constant dialog with small business owners, by getting outside of Washington, D.C., and traveling to business communities around the United States. We must also make a special effort to maintain open doors of communication with our key partners, such as financial institutions, private investment companies, and trade associations. This is the only way we can determine whether our programs can be improved, or if our programs are reaching the people that need the most help.

The deputy administrator must have a strong working relationship with the administrator, based on mutual trust and respect. I have had the pleasure of working with Administrator Lader since the early days of this Administration. I have the highest regard for his business and organizational acumen, and his leadership skills. I share his vision for this agency, and I look forward to building further on this relationship.

Mr. Chairman, if I may, I would like to take a few moments to tell you about myself, the person. The foundation for my professional and personal life is rooted in my Chinese-American heritage. In 1921, my father came to this country from Canton, the southern part of China, after a 30-day journey by ship. Upon his arrival in San Francisco, and with the help of missionaries who pinned a note to his clothing, this 10-year-old boy somehow managed to travel by train and meet his father in Minot, North Dakota, where they worked in the railroad communities.

Finally, he saved enough money, traveled back to Canton, and met and married my mother. But she could not join him in the United States for several years because of the Chinese Exclusion Act, a law passed by Congress in 1882, which prohibited Asian immigrants from bringing spouses to the United States. Upon its repeal in the early 1940s, my mother was finally able to join my father. From that point forward, he worked as a postal clerk for more than 30 years, trying to support a family of seven. He and my mother ran a small furniture business at which they worked during the evenings and weekends. I began to help out at the store when I was 7 years old and continued to work there throughout my college years.

I was reared by parents who believed in hard work, integrity, and fundamental family values. I learned that individual responsibility meant accountability, and that mutual responsibility was something to be practiced and lived. Loyalty, consensus-building and bridge-building were the core values which held our family together during the good times and the lean years.

These are the values that will serve as the cornerstone for my work on behalf of this Administration. As a civil servant, my father firmly believed in public service, that it was something to be hon-

ored. In commemorating the public service of some of my former colleagues at the Department of Commerce President Clinton said, "They believed that America, through their efforts, could . . . help to bring a better tomorrow through honest work and shared enterprise."

When I think back upon my father's saga, I know what compelled this young boy to travel alone across the Pacific. He firmly believed that America could give him the opportunity to achieve his dream of a better tomorrow through honest work and shared enterprise.

Mr. Chairman, this Committee has had a long history of bipartisan support for our Nation's small business, and I look forward to working with you and other members in this spirit. Helping America's small businesses to grow and to create more jobs are goals we can all support. In the last 3 years, the SBA has increased loans to women-owned businesses by 297 percent; loans to minority-owned businesses are up 181 percent; and loans to veterans have increased by 130 percent. Small businesses now employ 54 percent of the private work force in the United States.

SBA's programs are essential to a vibrant, growing economy. If I may, Mr. Chairman, I would like to introduce for the record a map of the United States which shows the economic benefits that every community has received based on just three of the agency's most popular loan programs. While I do not have the benefit of Administrator Lader's experience with many of these programs and will defer to his expertise, I believe the map illustrates how important SBA's programs are to job and business creation.

The small business community continues to need our support, and deserves our support. If confirmed, I pledge to work closely with members of this Committee, and the business and financial communities, to deliver SBA services in a more efficient and timely manner, in the hopes of enabling more people to realize their dreams of a better tomorrow through honest work and shared enterprise.

Thank you for your consideration. I will be pleased to answer any questions you may have.

[Attachments to the statement of Ms. Lew follow:]



Biography

U.S. Small Business Administration

GINGER EHN LEW DEPUTY ADMINISTRATOR -- DESIGNATE U.S. SMALL BUSINESS ADMINISTRATION

Ginger Ehn Lew has been nominated by President Clinton to serve as the Deputy Administrator of the U.S. Small Business Administration. The Deputy Administrator serves as chief operating officer for the agency and is responsible for policy development, program supervision and the day-to-day management of agency operations.

Before coming to SBA, Ms. Lew served as the general counsel of the U.S. Department of Commerce with management responsibilities for more than 375 attorneys and legal professionals providing advice on a broad range of issues.

Ms. Lew has more than 22 years of corporate and government experience. Prior to joining the Clinton Administration, Ms. Lew worked with a start-up, bio-mass technology small business based in San Francisco. As vice president and general counsel, she was involved in all phases of its operation including product development and licensing agreements, product patent and trademark registrations, regulatory permitting and site approvals.

Ms. Lew had previously spent eight years as a regulatory and business advisor to small, medium and Fortune 500 companies, with a primary focus on international markets. Her clients included large and small computer hardware and software manufacturers, environmental technology manufacturers and distributors, consumer goods manufacturers, and professional service companies.

A native Californian, Ms. Lew received her law degree from the University of California at Berkeley (Boalt Hall) in 1974, and her undergraduate degree in Political Science from UCLA. Ms. Lew has practiced law with private law firms as well as government agencies. She also served as deputy assistant secretary for East Asia at the State Department during the Carter Administration.

Ms. Lew has been active in civic and Asian American community organizations in San Francisco and Washington, D.C. She was co-founder of the Asian Pacific American Bar Association of Washington, D.C. She has served as chair of the National Democratic Caucus of Asian Pacific Americans, and of the Judicial Council of the Democratic National Committee.

Ms. Lew has spoken before numerous trade and legal associations and is the co-author of two books on international trade. She serves as the U.S. co-chair of numerous international legal committees. In 1994, Ms. Lew was appointed by President Clinton to serve on the Board of the Overseas Private Investment Corporation and the Council of the Administrative Conference of the United States.

Ms. Lew is married to C. Lennart Ehn. They have two adult children and maintain their permanent residence in Walnut Creek, California.

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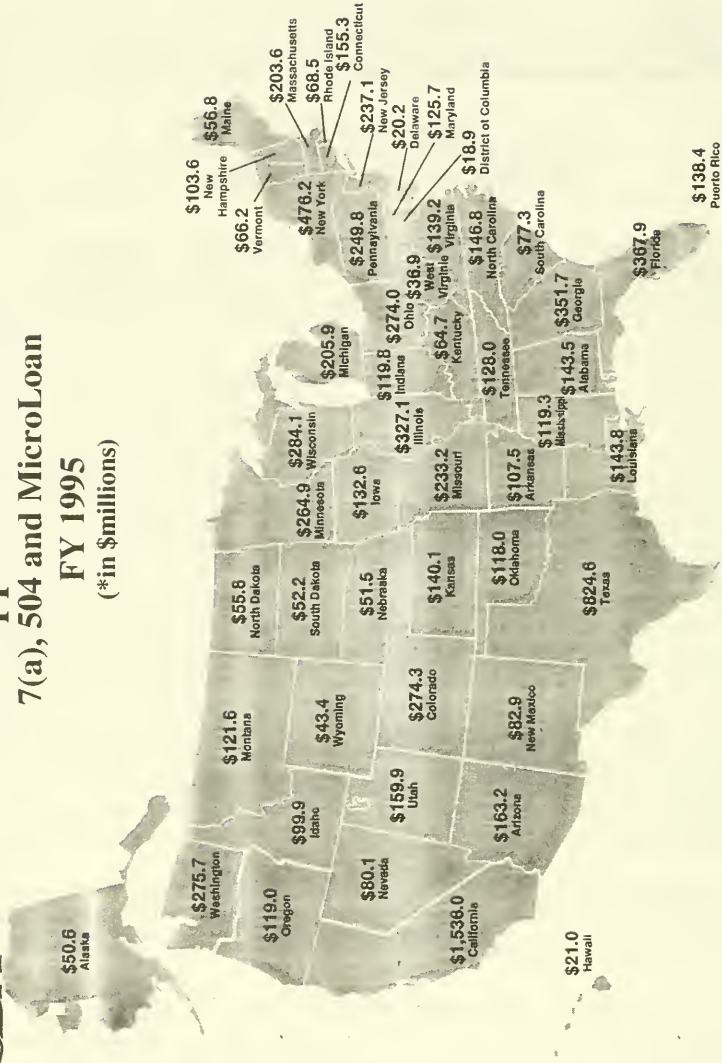


Loan Approval Amounts*

7(a), 504 and MicroLoan

FY 1995

(*in \$millions)



(4/29/96)

Chairman BOND. Thank you very much, Ms. Lew. I have had the opportunity to talk with you about some of the activities in the Small Business Administration and realize that in many of the more complicated financial affairs of the SBA that we will direct our questions to Mr. Lader who has a longer background there. But based on your experience in the Department of Commerce I thought there were a couple of areas where you might be able to give us some insights.

You had the opportunity to work with the Economic Development Administration. Some people have suggested transferring the EDA to the SBA. Do you think that would contribute to the mission of SBA? Would that kind of transfer be a good idea?

Ms. LEW. Mr. Chairman, the fundamental responsibility of the EDA is to develop programs that are community-based and community-driven. In other words, programs that will benefit the entire infrastructure of a community. I think SBA's primary focus has been to focus on providing support and assistance to business owners and potential business owners and individuals. I think they are very complementary and work in tandem, but the Economic Development Administration has enjoyed, I think, excellent management and support within the Department of Commerce and it would do well to remain at the Department of Commerce.

Chairman BOND. What about the Minority Business Development Agency in the Department of Commerce, is that something that should or could fit into the work of the SBA?

Ms. LEW. Mr. Chairman, the Minority Business Development Administration, as you know, provides technical assistance targeted specifically to racial and ethnic minority groups around the United States. Their operations are located primarily in urban areas and in locations which are traditionally underserved. Again, while there are some programs which are complementary and there may be areas where we can do some streamlining, given the unique mission of the MBDA within the Department of Commerce I believe it is appropriate and prudent to maintain a joint but complementary effort.

Chairman BOND. You would keep it separate?

Ms. LEW. Yes, I would.

Chairman BOND. You would keep it in the Department of Commerce rather than the Small Business Administration?

Ms. LEW. Correct. But I do believe that there are some efficiencies which can be achieved by streamlining some of the operations there.

Chairman BOND. Last year I introduced something called the HUBZone Act of 1996 designed to target small business preferences to economically distressed, low-income rate, high poverty, high unemployment rate areas. Do you have any suggestions or comments on that proposal based on your experience with Commerce as well as SBA?

Ms. LEW. My personal opinion with respect to any program which attempts to attract small business opportunities to underutilized or economically challenged regions is something that we should support and find ways to implement. I have not had the opportunity to review the proposal in detail.

One of the areas, if I recall correctly, had some focus related to self-certification. I know this is an area that has attracted some concern on the part of some members of Congress with respect to potential abuses of fraud or waste. I would welcome the opportunity to work with you and members of your Committee to review that proposal in further detail to see if there are ways that we can support the concept in principle.

Chairman BOND. Thank you, Ms. Lew. One final area that I think we need to straighten out. During the Committee's review of the background information submitted we noticed on the joint tax returns that despite several substantial six-figure incomes you showed no tax liability for the years 1992 through 1995. We have had good discussions between our Committee staff and your accountants. I understand that this resulted from losses generated in a limited partnership, or two limited partnerships. Could you just give us a general outline of how that came about? And we will continue to work with your accountants so that we can understand what happened there.

Ms. LEW. Up until the period of 1992 my husband and I, both before we were married and, obviously, afterwards as joint filers, participated willingly and on time in paying the appropriate amounts of taxes that were due to the Government. My husband was serving as senior vice president of a northern Virginia real estate development company and part of his compensation package called for receipt of a percentage of interest in various limited partnerships in projects around northern Virginia. As you know, northern Virginia went through a significant economic adjustment in valuation of real estate in the late 1980s and early 1990s.

As a result of the devaluations of many of those properties, significant losses were generated. As a result, a portion of those losses were assigned to us through our K-1 forms. It is my understanding that those losses will no longer be available to us at the end of, I believe it is this calendar year. We will have used them all up, and we should be returning to our normal status as regular and timely taxpayers.

Chairman BOND. So this was compensation to your husband that was taxed fully as compensation, and then when the real estate which was transferred as part of compensation became worthless the sums previously taxed became worthless or declined in value? Was that the basis of the—

Ms. LEW. I think in principle—again, not being fully familiar with how some of these real estate ventures are structured and re-structured and assigned—but in principle, that is the case, yes.

Chairman BOND. Thank you. We will look forward to continuing to work with your accountants to understand that.

Let me turn now to Senator Bumpers.

Senator BUMPERS. Ms. Lew, just to pursue that for a moment. I am not sure I understood. Was this a limited partnership originally . . . this development?

Ms. LEW. My husband served with a real estate development company which had a number of developments around northern Virginia. Each one of the developments were structured into partnerships. And as part of his compensation package he received a small percentage or an interest in each one of these projects. When

the valuation of the particular project went down, especially in the late 1980s and early 1990s, that is when we started accumulating the losses.

Senator BUMPERS. You will recall in 1986 we passed a very comprehensive tax reform bill here. It was devastating not just to your partnership but to limited partnership programs all over the United States. Some went under as a result of the changes we made in that tax bill. I was just curious, was it the 1986 bill that caused these—what had looked like very promising items—to fail?

Ms. LEW. To the best of my knowledge, the 1986 legislation did not have an impact. It was the valuation of the projects themselves.

Senator BUMPERS. Let me ask you this. The losses that you show, from 1993 through 1995, the losses that you offset against other income, was that income that you had paid taxes on previously?

Ms. LEW. I believe so, yes. I have asked the Committee staffers to provide any of those questions that they might have with respect to the tax returns to me so that we can sit down with the accountant to review the matter in detail. But with respect to any taxes that were appropriately due on compensation received, we did pay them.

Senator BUMPERS. Mr. Lader, let me ask you two or three just very brief questions. On the MicroLoan program, can you anticipate right now how much we are likely to carry over in that program? The request this year is considerably less than it was last year, but as I understand it there will be a carryover. My question is, do you have any idea how much that carryover might be?

Mr. LADER. I could give you that number for some of the other programs. As to MicroLoans, let me ask Patricia Forbes if she might come up as well and Greg Walter.

Senator BUMPERS. Patty, do you know the answer to that?

Mr. LADER. Greg, do you know the carryforward in the MicroLoan?

Mr. WALTER. We have not done the analysis yet, Senator, on determining what the projected level will be. But we do expect to carry over funds this year. We will be happy to provide that to you.

Mr. LADER. We will provide that to you promptly.

Senator BUMPERS. Now last year we had a \$60 million program and this year the request is \$38 million. I am just curious as to how much of that \$60 million that we had for 1996 is going to be carried over to the 1997 budget. In addition to that, do we have the authority to carry that money over and use it for 1997?

Mr. LADER. We certainly do.

Senator BUMPERS. Second, I see Berkie sitting back there and I know he has been down to Fort Smith. I was just curious, what kind of a staff do we have in Fort Smith now and how well is it functioning? Berkie, do you want to just stand up and identify yourself for the record and tell us?

Mr. KULIK. For the record, I am Bernard Kulik, associate administrator for disaster assistance at the Small Business Administration. We do have a staff in Fort Smith. We are present both at the FEMA State disaster field office and at the disaster recovery centers that FEMA and the State have jointly opened. We also have

employees there who are actually doing the work of verifying losses. At this point, Senator, we have already approved the first nine loans in the area for something over \$100,000. I can supply for you the exact number of staff and their location.

Senator BUMPERS. How many applications have you had so far, do you know?

Mr. KULIK. No, sir.

Senator BUMPERS. They are estimating the damage down there at \$500 million, which is staggering for a city the size of Fort Smith.

Mr. KULIK. At this point we have given out over 1,500 applications, and of course, the filing period is not anywhere near being terminated right now.

Senator BUMPERS. Thank you, Berkie.

For the edification of the Committee, it is estimated that 2,600 homes in Fort Smith were either destroyed or damaged.

Finally, Mr. Lader, one question that I am not quite clear on, and that is these so-called memorandum accounts in the 504 program. Could you explain to us how that has been handled in the past?

Mr. LADER. I am going to refer to our acting chief financial officer, if I might.

Senator BUMPERS. Would you identify yourself for the record, please?

Mr. WALTER. Certainly. My name is Greg Walter, the acting chief financial officer for the SBA. The accounting for the 504 program is somewhat unique in the realm of all SBA's accounting because of the uniqueness of the SBA taking a second position on loans that are made under the 504 program. When there is a default on the debenture and the SBA must purchase the debenture we, in more cases than not, have to also purchase the first lien position in order to put the Government in the best position to be able to foreclose on the collateral.

In doing so, we take on the collateral ourselves and a lot of times, in fact, then take a note back when we sell it at foreclosure. The establishment of that note is the second set of accounting that you are referring to as the subsidiary accounts that we use. That is a normal procedure that we have been doing for the accounting for 504 since the program first started. I think what you are probably referring to is maybe the differences in why the subsidy rate was calculated the way it was recently.

Senator BUMPERS. Yes.

Mr. WALTER. Back in the prior years of credit reform there was not enough history behind the program, because it started in 1986, to actually have loss experience sufficient enough to be able to provide good estimates going forward for adjusting subsidy rates. Now that we have concluded the study in 1995, we in fact have about a 10-year history of the program which includes a good history of default and recovery experience for the program. This history is used as a basis for the reestimate of the subsidy rates.

We now have some good information to base the estimates on, where back in the early 1990s there was insufficient information to be able to provide for a good estimate. There were estimates, but there was not really historical information to base those on.

Senator BUMPERS. Thank you very much. I am not sure I fully understand exactly how that works, but I will pursue that further with the staff. If necessary, I will give you a call, and we can discuss it further.

Thank you, Mr. Chairman.

Chairman BOND. Thank you very much, Senator Bumpers.

Now, Senator Kempthorne.

Senator KEMPTHORNE. Mr. Chairman, thank you very much.

Mr. Lader, the Balanced Budget Downpayment Act which was passed last week contained in it \$100 million for your disaster loan fund. Based on your own estimate, do you feel that that will be sufficient to get you through the remainder of this fiscal year?

Mr. LADER. It is our present estimate that it will do so. As you look to hurricane season, for example, in the fall, the timing of that is a question. Consequently, it may be only enough to get us through this year and we cannot anticipate whether there would be any carryover to next year. But we believe, under our current projections, it is adequate.

Senator KEMPTHORNE. Also, Mr. Lader, other than what we have already discussed this morning, is there any other area of concern that you would flag at this point that in the future you might be back before this Committee and say, a concern I had has now realized and we now need to discuss it further?

Mr. LADER. Probably three areas of concern that I want to make sure that we always keep on the table. We have had a dramatic growth in the loan portfolio, as you can see. To a considerable degree, as Ms. Lew has pointed out, there has been a focused effort to try to ensure that certain groups in the society that have not had access to capital can have greater access to capital, but not at the exclusion or diminution of the participation of any other group. So there is this overall increase.

The LowDoc program which is, as you know, for loans under \$100,000 where we took what was a voluminous application and reduced it essentially to one page after the local lender is satisfied, has been the principal reason for the significant growth of the number of loans in the last 18 months. All of our analysis to date suggests that those loans are performing at least as well, and almost counterintuitively, perhaps better than the rest of the portfolio.

But any time you have a relatively new product that has had an explosive growth, it takes continued close monitoring. We are doing so and we will continue to work with the Committee to make sure that there are not problems with LowDoc. But it is something that I certainly want to make sure we all recognize, it is not yet a seasoned portfolio. That is my first concern.

The second concern is, just as the effort of the past year resulted in this most comprehensive review of our loan portfolio, there may well be other aspects of the agency's efforts, whether in disaster or something else, that has not had such detailed scrutiny—25 million specific transactions—where the data may surface other conclusions. At this juncture, there is not anything to my knowledge that suggests there are problem areas that merit that type of scrutiny.

But at the same time, whenever you have sunk a shaft so deep in one area and come up with some surprising conclusions, it

makes you at least raise questions about other areas. But I must tell you at this point, there is nothing that gives us cause to say we must have that level of analysis.

The third point, as the Chairman is aware, there are certain legislative changes that would be required for the President's budget to be able to impact our programs in the way that is proposed. The 504 changes, the enhanced Small Business Development Centers and the like. So those are not matters of investigation as you might suggest, but they are matters for legislative changes that I am sure we will be discussing subsequently in this hearing.

Senator KEMPTHORNE. Also, Mr. Lader, with regard to the rate of repayments versus defaults, is that holding steady? Are we seeing any changes?

Mr. LADER. Actually, in the recent loans there is some improvement, some noteworthy improvement in the currency rate. I will be very quick to say, the currency rate, because the denominator in that is the total number of loans, I want the whole Committee to understand that as the loan portfolio grows, that has what may be perceived as a positive impact on the loss rate. Our loss rate today compares very favorably with the most conservative financial institutions. The currency rate, as I pointed out, is well over 90 percent now.

Those are two of the principal indices for commercial institutions when they look at their portfolios. But they are only two. There are other indices as well. So our loans seem to be performing better today than they have in the past. But we have to work on addressing the problem that OMB pointed to in the subsidy rate change which is, how do we improve our liquidation procedures? That is a matter of great administrative effort right now.

Senator KEMPTHORNE. Thank you.

Ms. Lew, my question to you, based on your perspective thus far of the SBA, what particular change or changes do you intend to bring under your tenure?

Ms. LEW. One of the areas of significant concern to me focuses on the aspect of modernizing and automating some of our practices. I think one of the ways we can make all our SBA employees more productive is to give them the technology and the training to lessen the burdensome paperwork that hampers our agency. I am hoping that we can move forward on the information technology master plan that the agency has been working on for the last several months.

Senator KEMPTHORNE. Thank you. Please tell your son, Jeremy, that he will love fly fishing in Idaho.

Ms. LEW. I will.

Senator KEMPTHORNE. Thank you.

Senator BUMPERS. Mr. Chairman, I am going to have to run to the Defense Appropriation, and I just wondered for the record, if we could get the staff's concerns about Ms. Lew's taxes resolved say between now and next week? Would it be possible to take up her nomination next week? We have got a hearing scheduled—

Chairman BOND. We have a hearing scheduled I think on the 22nd.

Senator BUMPERS. Is that the next hearing?

Chairman BOND. That is a markup. We were going to try to get everybody turned out for the markup on the 22nd. We were focusing on that.

Senator BUMPERS. We will take Ms. Lew's nomination up then?

Chairman BOND. Yes.

Senator BUMPERS. The only reason I raised that is because that pushes right up against the recess, and I was just hoping that we could get her confirmed before the recess if at all possible.

Chairman BOND. We will be happy to work with you on that.

Senator BUMPERS. I thank you, Mr. Chairman.

Chairman BOND. Thank you.

Senator SNOWE.

Senator SNOWE. Thank you, Mr. Chairman. I would like to include a statement in the record, if I may.

Chairman BOND. It will be accepted in full.

[The prepared statement of Senator Snowe follows:]

PREPARED STATEMENT OF SENATOR OLYMPIA J. SNOWE
COMMITTEE ON SMALL BUSINESS
MAY 1, 1996

Thank you, Mr. Chairman.

Allow me to welcome our guests this morning - Congresswoman Nancy Pelosi, SBA Administrator Phil Lader, and Ms. Ginger Ehn Lew. I am pleased that you are all with us.

Ms. Lew, you come to our Committee with strong credentials and an impressive background. I am confident that you are strongly qualified to serve as the Deputy Administrator of the SBA, and wish you well in that position.

As the Senator from Maine -- a state with a historical record of self-reliance and small business enterprise -- I am keenly interested in the Small Business Administration and the role that it can play in promoting small business development and growth.

Of the 29,920 business firms with employees in Maine, all but 700 are small businesses. In addition, 61.4 percent of Maine's private non-farm workers were employed by small businesses in 1991 -- far exceeding the national average of 53.1 percent.

Although Maine's economy is especially reliant upon small businesses, we can not overstate the significance of small business on the national economy. Since 1982, small business has increased by 49 percent and reached a record level for newly-formed small businesses in 1993 with over 706,000 businesses started. These entrepreneurs employ 54 percent of the private workforce, contribute 52 percent of all sales in the country, and are responsible for 50 percent of private GDP.

The Small Business Administration has played an important role in development, training, and disaster assistance for small businesses both in my State and across the nation. Therefore, I support adequate funding for this agency and the programs that it administers.

Nonetheless, in this time of needed deficit reduction, all federal departments and agencies will be called upon to focus on cost-effective approaches to management and programs. That is why I believe we must focus on results - on "performance-based budgeting" that will require that the SBA to work toward a leaner, more efficient organization.

I am, therefore, concerned to see that the latest budget proposal of President Clinton includes a \$664 million funding request for the SBA in 1997 -- an amount even greater than that requested in 1996. If we are to work toward a balanced budget, we must be sure that funding requests for federal programs are both justifiable and realistic. In light of the reform initiatives being undertaken at the SBA in the last year and one-quarter that were touted as "cost savers", I am concerned that this increased budget request may be lacking under both of these standards.

Thank you for being with us this morning, Mr. Lader. I look forward to your testimony and your explanation of the President's budget request for the Small Business Administration in FY 1997.

Senator SNOWE. Thank you. I welcome our witnesses here today.

Mr. Lader, can you continue to discuss the reasons for the increase in the subsidy rate on the 7(a) program because obviously that is a reversal from the position that was taken by the Administration and SBA previously? And given the OMB analysis of what is occurring, I would be interested to hear your thoughts on exactly what is happening and why the change in the direction with respect to the amount of the subsidy rate.

Mr. LADER. Senator, thank you for taking the interest in that very technical question which goes to the heart of the whole increase in the President's budget request. If I might take the liberty to be technical in an eyes-glaze-over sort of way, let me step back a little bit to put this in context.

The subsidy rate in prior years for the 7(a) program—as we all are aware, the subsidy rate is the equivalent of a loss reserve that a lending institution would have. It is the part of our appropriation that we never see. It stays at the Treasury as a reserve for potential losses. OMB is, by statute, designated as the entity to determine, of course, what the appropriate loss rate might be and, therefore, what the subsidy rate must be.

The subsidy rate was considerably higher in prior years. Two years ago it was about 2.74. Last year, because of the common work done by the Congress and the executive branch and by the imposition of some modest fee increases on the principal beneficiaries of the program, the lenders and the borrowers, and by the reduction of the percentage of the loans guaranteed by the Government, the subsidy rate was able to be reduced by OMB from that 2.74 to a little bit over one. Meaning, for every hundred dollars we guarantee we had to put aside one dollar that we never saw in our appropriation as that reserve.

Under the Credit Reform Act, all of the credit agencies are directed to review their portfolios. Now whether this wins an award for good government or not, I must say that we took very conscientiously that requirement and conducted what OMB today acknowledges is the most comprehensive credit review of any portfolio of any credit agency in the Federal Government. That reviewed 600,000 loans in the period 1983 through 1995; 25 million individual transactions. It took 1 year to complete this study.

When we completed the study and reviewed the work with OMB what was found was that loans in the mid-1980s had not performed as well as had been projected and that was the basis of prior subsidy rate determinations by OMB. What this meant is the number of loans that had to be repurchased from the local banks by the SBA was higher than had been projected, and then the recovery on those loans was less than had been projected.

Senator SNOWE. What was the rate at that point, the rate of subsidy?

Mr. LADER. In the mid-1980s the subsidy rate was——

Mr. WALTER. We did not have a subsidy rate until 1992, the first year of Federal Credit Reform.

Mr. LADER. Because that is part of credit reform. Thank you. That was an excellent question. I am sorry I did not respond in that way.

Amongst the phenomena giving rise to this, just in terms of business phenomena—Greg Walter made reference to the second position we have, for example, in the 504 program. If the collateral is real estate and the real estate value has gone down—this seems to be a recurring theme of this hearing—then the Government has less to go after, if you will, and the recovery is less.

And if the loans are weighted in particular areas of the country, in this particular case the West Coast or elsewhere where that fall in the values was greater than it was overall, the recovery is even less. You know well in Maine and New England what happened in the real estate industry in the mid-1980s period. So that is one of the phenomena giving rise to the recovery being less than what had been projected.

Now in our discussions—and they were repeated discussions with OMB—as to how you would then reach the conclusions as to what the subsidy rate would be, there are various analyses you could use as to how do you weight different cohorts, different years. I would argue that because today the program is very different from what it was in the mid-1980s, the lower percentage of the guarantee, greater fees and the like, that there should be a higher weighting on the most recent loan experience.

But OMB wanted to take the most conservative approach possible giving equal weighting to these different cohorts of loans. That is what led them to raise the subsidy rate, requiring the President to ask for more money for our budget to have the same program level.

Senator SNOWE. The increase in the request for the budget for SBA is solely directed to the SBA subsidy rate, the 7(a) subsidy rate?

Mr. LADER. Virtually in its entirety. There are some other small elements, but really very small elements and I can go into those.

Senator SNOWE. Because that is a major increase.

Mr. LADER. Absolutely. And the increase is devoted to trying to keep the same program level of loans for small businesses.

Senator SNOWE. In the LowDoc program, has that been a positive or a detrimental effect on the 7(a) subsidy rate? Did that have any implications at all?

Mr. LADER. It certainly had implications, but the implications had no direct effect. What I mean by that is, if you were to look at the performance of the LowDoc portfolio, it is performing today better than the SBA \$100,000 loans that are not in LowDoc, and performing about the same as our overall portfolio. So it was taken into account but it did not have an effect because at this juncture it is performing in the same way the rest of the portfolio is.

Senator SNOWE. Thank you.

Chairman BOND. Thank you very much, Senator Snowe.

Senator Bennett.

Senator BENNETT. Thank you, Mr. Chairman. And thank you, Mr. Lader, because Senator Snowe has asked the same questions, as did Senator Bumpers, that I am concerned about: the increase in the subsidy rate. My instinct as a businessman is to look at the most recent experience to make a decision as to where your loans are and how much of a reserve you need, instead of going back to a longer statistical era which may make the statisticians feel a lit-

tle more comfortable but violates anybody who knows how the market works. Because things go up and they come down, and if you take the overall average you are apt to get caught. You are either too far down or too far up.

Can you go back to OMB and say, listen to me, I have a business background and this would make more sense?

Mr. LADER. The irony is, since I spent the first year in the Administration as deputy director at OMB for management I was discussing with my successor these very issues. I can very well understand why he and Alice Rivlin took the position they did on this because by statute OMB is required—I cannot remember the specific language—but it is to look at the full business cycle and to look to a historical period in determination of what the subsidy rates should be.

So here you or I as businesspersons would be arguing, look at the most recent year's performance, look at the way the program is structured now, and OMB would come back and say, but we are required to look at a full business cycle by law. There are different approaches as to how you could weight looking at the different cohorts in that business cycle, and that was a matter of our discussion with OMB. But I have to tell you, they took the most conservative approach.

Senator BENNETT. Let us look at the other end. Let us look forward and ask ourselves what is going to happen to the program now that the subsidies have been raised so dramatically. What is going to be the impact in the marketplace? Do you have any ideas? I know OMB does not because they are required always to look backward. But those of us who have done business recognize that you never, ever prosper on the basis of your past laurels. You always have to sell again tomorrow when the doors open again.

So have you done that and can you give us any idea as to what we are looking forward to?

Mr. LADER. Rather than looking at a crystal ball, let me look at what we know from this year's experience to see how we might project from that. What we have seen this year is that the velocity of small business lending through the SBA program is slower than we had projected. What that means is, we thought we would go to about \$10.5 billion in the aggregate this year. On current projections for this year, it looks like we will do about \$8.5 billion.

Now why? I think that gets to the heart of your question. There are several reasons. One, the Government shutdowns. We had a period of 6 weeks to 2 months where our 7,000 lender partners did not find us, frankly, a very reliable partner as the Government. I think part of that contributed to the shortfall.

In addition to that, what helped us achieve the lower subsidy rate this year was the imposition of the fees which I referenced earlier. I think the trade associations would properly point to that as one reason why some of the lenders and borrowers have said, wait a second, we just cannot afford that. We cannot cash-flow, as Senator Wellstone had said earlier. Or frankly some have said, we can get similar financing, though perhaps not the same maturity, elsewhere rather than going through SBA. To which I say, fine. If they can get the funding elsewhere and we have a lower program, I do not complain about that.

Senator BENNETT. Sure, neither do I.

Mr. LADER. I would also say that one other difference is, I believe that most businesspersons would say there is greater liquidity in the banking system right now and more small business loans are being made and SBA is not as necessary. But that should not let us suggest that when that faucet gets turned the other direction that there is no need for the SBA programs still to be there as well.

So right now we can say that we are still at an all-time record but it is less, than what had been projected for this year. As we look going forward in the subsidy rate, it is the President's belief and mine that to have a constant and growing level of the guaranteed loan capacity is in the interest of small business and the general economy. If we were to keep only the appropriation we had this year for next year, under the new subsidy rate we would go from an \$11 billion program to a \$4 billion program.

I do not find that acceptable to the small business community. That is the reason the President did what is very reluctant for any of us, asked for a budget increase almost exclusively to keep the program level at the same level. We would hope that OMB would find from more recent experience next year and the year after that the subsidy rate can again be reduced. But right now that is a crystal ball.

Senator BENNETT. I see. Thank you, Mr. Chairman.

Chairman BOND. Thank you very much, Senator Bennett.

Let me clarify a few things and then I do have some more questions in this area. With respect to the 504 program, is it true that in some instances SBA has purchased more senior liens on the property and has actually lost more money than the junior debenture was guaranteed for because a guarantee of say 40 percent, to foreclose on that the SBA had to assume prior liens and the total recovery was less than the amount put forward plus the guarantee on the loan?

Mr. LADER. Senator, let me respond first and then ask Greg Walter to fill in additionally. The genius of the 504 program, as you know, since these businesses are capable of taking on additional indebtedness—they are already successful—is to get the blended rate of what the commercial lender provides and what the Government-guaranteed portion provides. To get that Government-guaranteed portion down and to create the incentive for the lender to step in with its 40 percent requires that the Government take the second position.

So once we are in the second position, if the market phenomena puts us in the legal requirement of taking out that prior position and then you find that the prior position is worth considerably less than you by law are required to pay for, you find yourself specifically in the situation you find yourself. My answer therefore is, yes, by operation of the way this system is structured that has had to be done.

Greg, do you want to offer further comment?

Mr. WALTER. To add a couple points. One is, yes, we do buy out the first lien in a lot of cases in order to get a position such that we can liquidate the property. If we did not buy out the first lien in those cases, there would probably be very minimal, if any, recoveries on our debenture because of the second lien position. But the

analysis that we performed showed that overall we are getting 40 percent recovery on our debenture alone. Which means then in the cases where we are buying out the first lien, we are in fact recovering the entire amount of the first lien and then still getting 40 percent on the amount of the SBA debenture.

Chairman BOND. I guess my question is, are you required by agreement or statute to buy out that first, or are you not in a position where if it turns out to be a real turkey and you have got a guarantee on a second, you walk away from that—

Mr. LADER. It is a question of business judgment on that as to how you can for the taxpayers get the greatest recovery you can get.

Chairman BOND. You are not required though when you have that—

Mr. LADER. No.

Chairman BOND. But I understand there are instances where the SBA has bought out the first and actually lost more money by buying out the first. Is that true?

Mr. LADER. Yes. But when you are seeing, how do you protect the nut so you have something to go after to try to get something back for the taxpayers, between the period when you make the determination that we want to go after that nut and the actual recovery, the liquidation, there can occasionally be times when there is less there than you perceived there to have been when you made that determination.

Chairman BOND. I understand that, and I would be interested in knowing, if you will just provide us for the record the instances in which things turned out wrong as opposed to the other times, which we hope were the great majority, where it was a sound business judgment. We would like that for the record.

Mr. LADER. We will provide it for you promptly.

[In further response, Mr. Lader submitted the following:]

It would be an enormous undertaking to actually provide a case-by-case listing of those instances where SBA purchased a first lien on a 504 loan but recovered less than what was paid. Such a list could only be constructed by manually searching the records of all 504 liquidation cases over a specified time period, and many of those records are archived. It is estimated that a search of up to 900 case files would be necessary in order to provide such a listing for just the last few years.

That said, I would reiterate Greg Walter's comment that SBA's 40 percent recovery rate includes all liquidation actions, which include both those where first liens were purchased and those where they were not. In other words, the 40 percent recovery rate is the net recovery relative to disbursements on the SBA backed debentures. Where first liens have been purchased, on average, they have been fully recovered in addition to at least part of the 40 percent of our original debenture.

Chairman BOND. You have talked about the proposed change in the 504 program. That has not been approved by OMB yet, has it? Has that been formally approved?

Mr. LADER. While the legislative package has not been presented to you, because this proposal is presented in the President's budget, OMB has approved conceptually our going to direct funding.

Chairman BOND. We will take a look at it. As I have expressed to you there is I think some very great reluctance, which I would lead, to moving toward direct lending unless it was a clear and overwhelming choice. I will be interested to see what information is presented to us. We will look into that when OMB formally transmits that to us.

Mr. LADER. Mr. Chairman, one point of clarification, if I might on that. We are not recommending direct lending; direct funding.

Chairman BOND. Direct funding. How does that direct funding work?

Mr. LADER. A certified development company would still be participating in the loan, making that loan to the small business. The Treasury is providing Federal funds directly to the development company.

Chairman BOND. To the certified development company.

Mr. LADER. Yes, as opposed to Wall Street being the intermediary. But it is not, in the sense of direct lending, the Government lending to the end user.

Chairman BOND. The reason that that is supposed to have a zero credit risk; i.e., a zero credit subsidy is that there are sufficient funds in the development company to cover any losses?

Mr. LADER. What is built into the cost of that financing instrument is the equivalent of the fees that have been paid by the intermediary beforehand. So these fees are built into the subsidy rate to provide the necessary loss reserve. This is the sort of thing that we would like to, with OMB, go into greater detail with you, because I can understand your question.

Chairman BOND. We will be interested in seeing that. Also, as we talk through the increase in the subsidy rate I think it is important, and I believe you have made clear that the subsidy rate change that we have here is not in fact a change in the fees that are going to be charged such as several of my colleagues indicated.

If the amount appropriated by the Congress stays the same, which in this budget cycle that would be good news given the pressures on the budget generally, it would mean a reduction in the amount available. It does not affect the attractiveness of a particular loan to an SBA lender or borrower. I think there was some confusion at one point in some of the discussions. I think that is fair to say, is it not?

Mr. LADER. Entirely correct.

Chairman BOND. Also, next year's subsidy appropriation is used as a reserve for new loans only. There is nothing built in this, and the subsidy rate does not make up for any difference of higher losses above expected on prior year loans in the mid-1980s. This subsidy rate is designed to affect transactions for the future only, and it is not making up for the losses. It reflects what OMB thinks the losses were in the past, and therefore, looking in the rear view mirror they have made a judgment as to the road that they are traveling in the future.

There is 150 percent increase in the subsidy rate. Your study showed an increase in the repurchase of defaulted loans. What was the rate of defaulted loans in the fiscal year 1997 budget request?

Mr. LADER. Greg, do you want to address that?

Mr. WALTER. For the 7(a) program, Senator, the default rate is 17.25 percent. That is the same rate that was actually used in 1996. The major difference in the defaults was their timing, which caused the impact on the subsidy rate.

Chairman BOND. Pardon?

Mr. WALTER. The timing of the defaults; when they actually occurred over time. There was a difference between the timing that

we discovered through the study versus what we had estimated in the past. But we kept the default rate consistent with what was used last year, or 17.25 percent.

Mr. LADER. Let me explain. In these prior analyses, the time cost of money was not taken into account as a factor. When you have a loss and when you have the actual recovery; the period of time for these events is something that was included in this analysis and had not necessarily been in the past.

Chairman BOND. So there is a 17.25 percent default rate included in the calculations for 1997. And added to that is the time value of money lost during the period—if it is lost completely, obviously there is no time value of the money. The time value lost is only on the money recovered. That is added to the dollars lost. Is that the difference between the 1996 and the 1997 rate?

Mr. WALTER. For the repurchases, or loan defaults the time value or the difference in the timing of when we have to purchase the loans compared to the original date of the loans is what caused the default rate to change relative to the 1996 subsidy rate. Now there was also a change in the recovery estimates for the 7(a) program as well. In that case, not only the dollar amount of recoveries but the timing of the recoveries were different than the 1996 estimates. So the combination of those three factors: the actual recoveries and the timing of those, and the timing of the defaults were the factors in causing the subsidy rate to change.

Chairman BOND. Are there any other factors that caused the subsidy rate to increase than the three you mentioned?

Mr. WALTER. Those are the three principal factors, Senator.

Chairman BOND. On average, a bank or banks take 6 months to liquidate a loan and make the recovery. Based on the historical average of the SBA it takes about 2 years to make the recovery. Why should the SBA's period be a year-and-a-half longer so we are incurring the year-and-a-half time value loss of money.

Mr. LADER. I am going to ask Greg to comment further on this, but I want to offer at least two or three insights on that first. That is precisely the reason we want to move to a much higher degree of private sector liquidation.

Right now in the current OMB subsidy rate they are projecting that 20 percent of our liquidations will be done by the private sector. Already this year 37 percent of our portfolio requiring liquidation is being done by the private sector. That is because—let me clarify that—37 percent is being done through the PLP program, the preferred lenders program. In addition to that, we have the LowDoc program and the Fast Track program where, as you know, there is only a 50 percent guarantee and the lender must liquidate the loan.

So actually, 62 percent of our liquidation activity is being done through the private sector right now rather than through the Government. So you can see that we are trying to get more of it done by the private sector. We are very much moving in that direction.

A second point, which we have discussed before privately, there has been before the Congress a proposal to permit non-judicial foreclosure. This would be of tremendous help to us so that through an administrative process as opposed to going to the courts, we would

be able to foreclose on these properties and actually truncate the amount of time that it would take in order to have that recovery.

Let me ask Greg to comment on some of the other administrative matters within the agency of why it takes, or has historically taken longer for us to accomplish it than the private sector would.

Mr. WALTER. Senator, I believe that probably the principal factor why SBA's liquidation process may take a little longer than you would see in a normal commercial practice would be that we go through a tremendous amount of effort to try to work out a deal with the small business borrower.

We would much prefer not to have to sell property, not to have to foreclose on real estate, kick people out of their homes, out of their businesses, but try to work out something with them. So we go through a lot of extra effort to try to find out if there is some kind of work-out we can do with the borrower before we have to in fact liquidate. That probably is the principal reason why there would be a difference in the timing.

Mr. LADER. Senator, I am going to add to that a footnote. If you look at just one well-known example, which was not a liquidation issue but was a work-out situation, Ben & Jerry's. Twice in their early loan history with the SBA we had to step in and give them very extended terms and help them through work-outs. They are a very successful company today, and I can point to many other less well-known examples.

So both in terms of liquidation and in terms of how our agency works with the small business borrower, we are not driven by exactly the same criteria that the commercial lender would be. We want to help the small business try to succeed as opposed to automatically try to recover as fast as possible.

Chairman BOND. I think it is clear to say, you are not kicking people out of their homes. You are making business judgments on what businesses can survive. A good banker would not want to write off a loan if he or she felt that that business could get back on its feet. That does not make good business sense. By the same token, the SBA is not set up to watch dollars go down the drain for business loans that turn out to be bummer.

The other thing that I think I mentioned to you, the guaranteed lenders have continued to express to us the frustration with some of the procedures and the red tape of SBA that delay their ability to foreclose. I trust this is being addressed and that where foreclosure is necessary there will be less hassle and red tape from the SBA. Is that a fair assessment?

Mr. LADER. We are working very hard on that. When you look at one of the three principal factors in the increase in the subsidy rate being this liquidation process, we immediately initiated a major project agency-wide to address that. We are working very closely with the trade associations representing the lending institutions. They worked with us throughout the day yesterday, for example.

You should know in addition to that, Senator, we are including in the goals for our individual district directors for the first time, at least the first time in recent memory, liquidation goals. So we want to make sure that we are not only concerned with the number of loans going out the door, but how we are dealing with the prob-

lems on the other side of this process. So it is a matter of highest attention right now in the agency.

Chairman BOND. In February, you asked for comments in the Federal Register on ways to privatize disaster loan servicing. It is a different category. Any conclusions or any good ideas come from this process?

Mr. LADER. I must confess, the number of comments were not as large as we would have liked, though some good suggestions certainly were made. In addition to that, last September as you may recall, with the help of a contractor we began efforts to find out how we could further, if I might use the euphemism, privatize this whole process. In about 30 days the next stage of that report is coming due.

So we really have three different things going on simultaneously on this liquidation effort. One is the comment period on our proposal to obtain the outside private sector view. Second, our work with the lenders and the trade associations to say, how do we improve this process? Third is our devoting much more attention, with the incentive of new goals for the district directors to focus on how we can improve the liquidation process.

We would welcome any other suggestions from the Committee or your staff in these areas because they get to the heart of what the subsidy rate for future years will be.

Chairman BOND. Thank you. Just to clarify something. In your testimony you referred to a one-page loan application for a LowDoc loan. That is not what the borrower submits to the lender?

Mr. LADER. No.

Chairman BOND. That is what the SBA requires the lender to submit to the SBA; is that correct?

Mr. LADER. Exactly. We would not be fulfilling our fiduciary responsibility to guarantee a loan with a one-page application.

Chairman BOND. What does the borrower submit to the lender?

Mr. LADER. Whatever the lender would normally require for its loans.

Chairman BOND. That is the normal process.

Mr. LADER. But in the past it was a very cumbersome practice because after the lender's process was completed then, through very different forms and a different presentation of materials, the borrower had to rehash all of it to submit to SBA. So the one-page essentially is a quick Government review of what the bank has already done to its satisfaction.

Chairman BOND. Let me jump to the SBDC function. Please give me a quick overview on what you are requesting for the SBDCs.

Mr. LADER. What we are proposing is what we are calling an enhanced Small Business Development Center program. We are very proud of the fact that there are 950 Small Business Development Centers actively involved in helping small businesses around the country. At the same time, as part of the President's reinvention effort we proposed last year that the Small Business Development Center move to a much higher degree of self-sufficiency. Right now it is required by law that there be a 50 percent match by the State for the Small Business Development Centers. The total amount of funding for FY 1997 is requested at a little over \$72 million.

There is a simultaneous effort that has been occurring, particularly at the initiative of Senator Domenici as you are well aware, for women's demonstration programs around the country. We have about 50-some-odd of these operating right now but they operate in only 27 States. There was 3-year funding for this on a rotating basis. We have a concern, given the importance of women's business ownership and its growth in this country, that if we do not continue the emphasis in each of the States on women's business ownership, that there may be some shortfall in the continued growth of women's business ownership.

Consequently, what is proposed is that, to guarantee the continuation of this emphasis on women's programs, in each of the States one of the Small Business Development Centers will be directed by that State to focus on women's business development in that State. That would guarantee a great life period, if you will, of the emphasis on women's business ownership. Consequently, of the \$72.3 million that the President's budget requests for the SBDCs, \$2.2 million of that is to go for the women's grants that would help continue this effort.

In addition to that, about \$3 million is for so-called 7(j) grants. As you are aware, that is executive training principally for minority executives and minority small businesspersons. We believe that is best integrated with the overall Small Business Development Center program so it is not just Washington bureaucrats trying to provide that kind of training to small businesses, but it is the Small Business Development Centers out there in the field on the ground providing that.

So what this enhanced SBDC program does is keep the same program level. It incorporates the best features of the women's program and some of the 7(j) program, and it moves us, as I mentioned first, in our goal in 5 years, through the SBDCs imposing fees on their customers and gaining other sources of financing, for the SBDCs to be less dependent on the Federal budget and allow us to help achieve a balanced budget and still have a very strong SBDC program around the country.

Chairman BOND. But the Senate added \$4 million last year for the women's demonstration program, and the women's demonstration program is being moved into the SBDCs with actually a total of about \$1 million less funding for the SBDCs; is that fair to say?

Mr. LADER. Yes. I would like to think that through their internal resource allocation State by State that the individual SBDCs could say, women's business ownership is sufficiently important that we want to recognize that a percentage of our funding should be directed to it. So it becomes a bit of apples and oranges, the extent to which existing SBDC funding should be shifted to a focus on women's business ownership or not.

But you are exactly correct, we are trying to reduce the overall appropriation and sustain both of these programs in a way that could be mutually enhancing. Of course, if the Senate prefers to add additional funds to continue the women's program as a separate funding matter at a separate level, we and Senator Domenici probably would be very pleased with that. But this is our best way of trying to reduce the budget and achieve the common objective.

Chairman BOND. Sometimes things happen on the Senate floor that are totally beyond the scope, the authority, or even the knowledge of the members of this Committee. So we will watch with a great deal of interest what happens.

I did mention to you that Senator Hatfield and I had a colloquy about the need to reduce the staffing as a result of the request last year for more positions at SBA. You are requesting more staff for SBA in this year's budget?

Mr. LADER. Yes, from an authorized level but let me respectfully differ with the conclusion that that might suggest. Where we are right now under the current budget most recently signed by the President, we can fund about 3,030 FTE employees. Our current head count as of the end of this last month was 3,018 employees. These are non-IG and non-disaster. These are the business loan and other small business focused employees of the agency.

Under the President's request the number of authorized FTE is 3,122. But in fact, the dollars requested would not allow us to get to 3,122. The dollars requested would allow us only to stay at approximately the same level we are at right now. So it may be an increase of a dozen or a few dozen people. But when it gets down to the final analysis, when we take into account locality pay and everything else, it may well be that it is even fewer employees.

Chairman BOND. We have discussed previously the Small Business Regulatory Enforcement Fairness Act which becomes effective on June 28. For the record, I would like to have you give a brief description of how you plan to implement the provisions establishing the small business and agricultural enforcement ombudsman and the regional fairness boards. That would be of interest to us, I think.

Mr. LADER. Let me say as a prefatory note just yesterday, to demonstrate how excited we are about the passage of that, in two speeches I shared my frustration with what I think you must have, that when you do something that has 100 to zip support, because you do not have the kind of fury and political opposition, it does not get the media attention it should. I shared that frustration in two speeches.

Chairman BOND. The best kept secret in town. I heard someplace that the House slipped it in. One newspaper account said that this is something the House slipped into the debt ceiling bill. It seemed to me that at least 100 Senators knew that we were in favor of it. But thank you for the effort.

Mr. LADER. We continue making that point. You would be interested to know, also yesterday we co-hosted, with a variety of staff from the Hill, the first of the training sessions on judicial review of Reg Flex. I think we had—I spoke to the group, it probably was 50 or so trade associations representing small businesses present, to try to understand what this new law means for the whole Reg Flex environment. So we are very excited about it and we want to work closely with the staff of this Committee and any of the members to try to make sure the word gets out about it.

Now as to the particular ombudsman issue, what we want to do is to make sure that in this litigious society that this becomes a real and effective mechanism to absorb not just anxiety and complaints, but specifics that can be translated into programmatic

changes in the agencies and the like. So we want to look very closely.

I have had discussions with the Office of Presidential Personnel at the White House as to how do we determine who are the best people who can take the roles in this. We want to work with this Committee on that. We frankly want to work with the people who were representative's delegates at the White House Conference on Small Business because this was such an important issue to them as well.

So for the single ombudsman role in SBA as well as the committees around the country, we take that responsibility very seriously. I do not think you should expect any surprises. We are going to go slow, frankly, in the implementation of that to make sure we get the right people and that they recognize—because this could be a very time-consuming responsibility and we do not want to attract individuals who simply do it for resume value. We want them to do it because they have a passion for correcting what is perceived to be a very cumbersome regulatory process.

Chairman BOND. Mr. Administrator, thank you very much for your comments. Ms. Lew, thank you. And to the other members of your staff, we appreciate it. There may well be additional questions. There always are. We will leave the record open on this hearing, but we will continue to work with you. Thank you very much for your presentations today, and with no further business coming before the Committee, this hearing is adjourned.

[Whereupon, at 11:23 a.m., the Committee was adjourned.]

COMMENTS FOR THE RECORD



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May 1, 1996

The Honorable Christopher Bond
Chairman, Committee on Small Business
The Honorable Dale Bumpers
Ranking Member, Committee on Small Business
United States Senate
Washington, DC 20501

Dear Senators:

The purpose of this letter is to bring your attention to
Ginger Lew, who is seeking confirmation as the Deputy
Administrator of the Small Business Administration.

Ginger Lew is a rare individual with solid credentials in
both the private and public sectors which provided her with first
hand knowledge of both business and government. Ms. Lew would
bring the same spirit and strength that she showed as the vice
president and general counsel of her own start-up firm in San
Francisco, California to public service.

Thank you for your attention to this matter and please give
Ms. Ginger Lew serious consideration for confirmation to the
Small Business Administration.

Sincerely,

Barbara Boxer
United States Senator

BB:kh



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